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GENERAL HEARINGS

HEARINGS

BEFORE THE

COMMITTEE ON THE BUDGET
UNITED STATES SENATE

ONE HUNDRED TWELFTH CONGRESS

FIRST SESSION

MARCH 15, 2011—THE REPORT OF THE BIPARTISAN POLICY CENTER'S DEBT REDUCTION TASK FORCE

MARCH 16, 2011—MODERNIZING PERFORMANCE: USING THE NEW FRAMEWORK

SEPTEMBER 15, 2011—POLICY PRESCRIPTIONS FOR THE ECONOMY

SEPTEMBER 20, 2011—PROMOTING JOB CREATION IN THE UNITED STATES

OCTOBER 4, 2011—IMPROVING THE BUDGET PROCESS: STRATEGIES FOR MORE EFFECTIVE CONGRESSIONAL BUDGETING

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*On May 11, 2011 (S. Res. 179) Senator John Ensign was replaced with Senator Kelly Ayotte.

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THE REPORT OF THE BIPARTISAN POLICY CENTER'S DEBT REDUCTION TASK FORCE

TUESDAY, MARCH 15, 2011

COMMITTEE ON THE BUDGET,
U.S. SENATE,
Washington, DC.

The Committee met, pursuant to notice, at 10:02 a.m., in Room SD–608, Dirksen Senate Office Building, Hon. Kent Conrad, Chairman of the Committee, presiding.

Present: Senators Conrad, Wyden, Cardin, Whitehouse, Warner, Begich, Coons, Sessions, Enzi, Thune, and Johnson.

Staff Present: Mary Ann Naylor, Majority Staff Director; and Marcus Peacock, Minority Staff Director.

OPENING STATEMENT OF CHAIRMAN CONRAD

Chairman CONRAD. The hearing will come to order. Welcome to the Senate Budget Committee.

Before we begin today, I would like to take just a moment to send our thoughts and prayers to the people of Japan during the crisis that they are confronting. And I would ask that we observe a moment of silence in respect to those who have been lost and those who are suffering there.

[Moment of silence.]

Chairman CONRAD. Thank you for that. Now we will proceed with the hearing.

In this hearing today, I want to particularly welcome our two very distinguished witnesses: Senator Pete Domenici and Dr. Alice Rivlin. They served as co-chairs of the Bipartisan Policy Center's Debt Reduction Task Force. Our hearing today focuses on the task force's debt reduction proposal, titled "Restoring America's Future," which was issued in November. Both of our witnesses are very well known to this Committee. Senator Domenici served on the Budget Committee for 34 years, almost unimaginable, was Chairman or Ranking Member for 22 of those years. I served with him during many of those years, and I can tell you, Senator Domenici was a leader and somebody that we all had respect for in the way he conducted this Committee and the passion that he brought to the subject. Those years of service are Committee records, and I venture to say they will not be equaled. So, Pete, welcome back. It is good to have you here.

Dr. Rivlin is also a giant in the budget world. She was founding Director of the Congressional Budget Office, served as the Director of the Office of Management and Budget in the Clinton administration, held the position of Vice Chair of the Federal Reserve. In ad-

dition to co-chairing the Bipartisan Policy Center's Debt Reduction Task Force, Dr. Rivlin also served with me as a member of the President's Fiscal Commission, so she did double duty. And I can attest personally to the tremendous contribution she made to that effort. So, Dr. Rivlin, welcome back. She has been before this panel many times.

I believe our Nation is in peril. We are hurtling towards a fiscal cliff. We are borrowing about 40 cents of every dollar that we spend. Deficits have exceeded a trillion dollars for 3 years in a row. That is a trillion—not a million, not a billion, a trillion dollars. People tell me people have a hard time distinguishing million, billion, and trillion. Well, a trillion dollars is a thousand billion *dollars*. That is a staggering amount of money. So here we are. And the long-term outlook is even worse. We are clearly on an unsustainable course.

Before I go further, I want to also recognize Bill Hoagland, the former Staff Director of this Committee. Bill also served on the debt reduction effort that was led by Pete Domenici and Alice Rivlin. Bill was deeply respected by every member on this Committee during the time he served as Staff Director, both Republicans and Democrats. We may have differed on specifics. One thing you knew is Bill Hoagland was interested in what was good for the country.

Let me go to the slides, and for those who watch Budget hearings, I am repeating some of these things because I think it is so important to repeat them. The Chairman of the Joint Chiefs of Staff has said, "Our national debt is our biggest national security threat."

Make no mistake, we are at a critical juncture. Spending is at the highest level as a share of our economy in 60 years. Revenue is at the lowest level as a share of our economy in 60 years. Gross debt as a share of the economy will reach 100 percent this year, well above the 90 percent threshold that many economists regard as a danger zone.

Two of the Nation's leading economists, Carmen Reinhart and Kenneth Rogoff, have just completed a book on this subject, and they concluded, "We examine the experience of 44 countries spanning up to two centuries of data on central government debt, inflation and growth. Our main finding is that across both advanced countries and developing and emerging markets, high debt to GDP levels, *those above 90 percent*, are associated with notably lower growth outcomes." That is why all this matters. When you reach a gross debt of 90 percent, your future economic prospects are impaired, and impaired in a substantial way.

So when people ask, well, what does it matter whether you have got a debt of 90 or 100 or 120 percent of your gross domestic product, what matters is what that means for the future economic strength of the Nation. What that means is our future economic opportunity is going to be reduced—fewer job opportunities, fewer opportunities for all the American people, and a fundamental threat to the national security of the Nation. That is why this matters. So these debt figures are not just numbers on a page. They are things that affect the lives of real people.

And we are now dangerously indebted to foreign nations. Here are the top ten foreign holders of U.S. debt. We now owe China more than $1 trillion. I believe the only way we are going to solve the Nation's long-term fiscal imbalances is by enacting a comprehensive debt reduction plan. Frankly, we do not have time to do this one piece of the puzzle at a time. We have got to take this on comprehensively and put in place a plan that gets real results, dramatic changes in our circumstance over the next decade.

We need a package of the size and scope of the plans proposed by the President's Fiscal Commission and the plan put forward by the Bipartisan Policy Center. Although the plans differed on some specific policies, both took a balanced approach that included discretionary spending cuts, including defense, entitlement changes, and fundamental tax reform that simplifies the Tax Code, lowers rates, and raises revenue.

This chart shows the trajectory of debt under the various debt reduction plans. Under CBO's alternative fiscal scenario, which roughly corresponds to our current course, debt will rise to 233 percent of GDP by 2040. That will never happen because our lenders will never permit it to happen.

Under Chairman Ryan's road map proposal, debt—and this is not gross debt now. This is publicly held debt. Publicly held debt is substantially lower than gross debt. Under Chairman Ryan's road map proposal, debt will continue climbing to 99 percent of GDP by 2040. And, again, that is publicly held debt. Publicly held debt is roughly 70 percent at the end of this year. So you can see under his plan debt will continue to rise to nearly 100 percent of GDP by 2040 as measured by publicly held standards. Under the Bipartisan Policy Center plan, debt will fall to 54 percent of GDP. Again, this is publicly held debt. And under the Commission proposal, debt will fall to roughly 30 percent of GDP by 2040.

Chairman Ryan's road map proves the point that revenues, I believe, have to be part of a plan to reduce the deficit and debt; otherwise, the debt is too high. Under his plan gross debt would be about 130 percent of GDP, well above where it is today. The result is the plan increases the debt as a percentage of GDP for the next 30 years, instead of bringing it down like the other two plans.

Here is an overview of the Bipartisan Policy Center plan. That is the plan that Senator Domenici and Director Rivlin were the principal architects for. It lowers the deficit to 1.2 percent of GDP in 2015 before increasing slightly to 1.5 percent by 2020. It stabilizes the debt by 2013 and brings it down to about 60 percent by 2020 and 54 percent by 2030. Again, this is publicly held debt. It reforms Social Security, ensuring that it remains sustainable and solvent for at least 75 years. It phases out the health tax exclusion, caps Medicare and Medicaid growth, and creates a partial Medicare voucher. It provides fundamental tax reform that broadens the tax base, reduces rates, and dedicates revenues to reducing debt. It also includes a value-added tax, and it freezes domestic discretionary spending for 4 years and defense spending for 5 years.

This final chart compares the results in 2020 from the Fiscal Commission plan, the Bipartisan Policy Center plan, and the President's budget. It shows that the Fiscal Commission plan and the Bipartisan Policy Center plan result in similar outcomes for deficit,

debt, spending, and revenues as a share of the economy. Under an extension of the President's budget, we would see considerably higher deficits and debt and a larger disparity between spending and revenues in 2020. I look forward to more closely examining the specific recommendations in the Bipartisan Policy Center plan in today's hearing.

We will turn now to Senator Sessions for his opening remarks, and then we will hear from Senator Domenici and Director Rivlin. Again, I want to welcome you both. I am using your old title, Dr. Rivlin, but, you know, that is a high honor to have been Director, and I hope you will not mind.

Senator Sessions.

OPENING STATEMENT OF SENATOR SESSIONS

Senator SESSIONS. Thank you. Thank you, Mr. Chairman, and you continue to lay out the challenges before us, and we appreciate that.

Senator Domenici and Dr. Rivlin, it is a great pleasure to have you here today before the Committee to get your insights on the challenges confronting our Nation. The candor with which you have addressed these challenges is refreshing.

As you know better than most, we are on an unsustainable path. The question is not whether we are headed for a crisis but whether we act in time to prevent it. I believe it was a joint statement of Alan Simpson and Erskine Bowles that this is the most predictable crisis the Nation has ever faced. And after the disaster in Japan, I thought, well, had they known this was going to happen, what steps would they have taken? And I think you probably agree with the general consensus that we are heading to a crisis, and there are some things we can do now to make sure that we maximize our chance for prosperity rather than austerity.

Already our crushing debt burden is being felt by millions of Americans. It drags on our economy like an anchor, slowing growth, investment, and——

Hon. DOMENICI. I have to be excused for a minute.

Chairman CONRAD. No problem. You go ahead, Senator Sessions.

Senator SESSIONS. We were told that a massive surge in Federal spending would lead to recovery, but after three straight $1 trillion-plus deficits, we have a smaller fraction of Americans participating in the labor force today than at any point in the last 25 years. Opening the floodgates of Federal spending did not create a rising tide of prosperity, but it certainly has added a great debt burden to our economy.

A much heralded study from economists Reinhart and Rogoff, as you mentioned, Mr. Chairman, spells out the dangers countries with debt-to-GDP ratios beyond 90 percent suffer economically in terms of growth and in terms of shock, losing a point or more of GDP growth each year, which is a very significant drag on our economy. Many think that Japan's economy, which has been stagnant, has been stagnant in large part because of the huge debt that they are carrying. America's debt-to-GDP has already crossed this threshold and will climb to 100 percent by September 30th.

Secretary Geithner, our Treasury Secretary, testified before our Committee, and he called the study of Rogoff and Reinhart "excellent" and even cautioned it understates the risk.

Given the danger, you would think that Congress would begin to take action to confront this spending and debt danger. Discretionary spending, however, has swelled 24 percent since the President took office, and that does not include the stimulus package. That is the baseline expenditure increases. But our Democratic leaders and the President have opposed further action that would curtail those spending levels. The Republican proposal to cut $61 billion this year did, however, earn more votes in the Democratic-controlled Senate than the Democratic proposal to essentially ignore the problem with a mere $4 billion reduction.

So we can disagree on specific cuts, but not on the need, I think, for meaningful reduction, so I will continue to advocate for the $60 billion reduction. I think that is a significant reduction. Over 10 years it amounts to $860 billion in net savings and is something not so significant that we cannot achieve it.

Our long-term challenges remain, however, entitlement reform. But for Congress to have any credibility on entitlements, our first order of business, I think, must be to deal with the Washington Government. I think we should reduce our congressional budgets by 15 percent. I think that is well doable. It is the kind of leadership and example setting that we should set. These things do add up. The American people are not prepared to have their Social Security or their Medicare reduced as long as we are not willing to reduce any of our spending in this city. And it is a convenient myth that discretionary spending is insignificant, and it sort of protects us from having to confront our own wasteful spending and contain its growth. We can do that.

In your proposal, you recommend a $2.1 trillion discretionary savings over 10 years, but you do not address any reductions this year. I think we should do that again this year. It puts us on a better path and sends the markets notice that we are beginning to take real action, and I think the crisis that we all see out there looming is probably closer today than we anticipated even 6 months ago.

So I am much more optimistic about what we can achieve. I am confident we can find significant savings now in the discretionary budget and that doing so will reap lasting benefits. The first of these benefits is restoring investor confidence and helping create jobs and more investment in our country.

Washington has promised many times to curb the deficit, but mere promises will not be taken seriously unless they are brought forth and paired with real, credible action. Another crucial benefit is that any reductions we make now may have a magnified impact over the decade, as I noted.

Perhaps the most important reason to quickly trim our discretionary budget is the potential for a debt crisis. As I mentioned, Mr. Bowles and Mr. Simpson talked in terms of 2 years or less that we could be facing a crisis. Alan Greenspan used the phrase "2 to 3 years" we could have a crisis. The world's leading bond investor, Pacific Investment Management Company (PIMCO), has reduced its debt.

So we have been given a warning that the Japanese were not given with this earthquake, and I think it is time to take action. The time for delay is over.

So we have a critical opportunity to begin a new course, and this Continuing Resolution (CR) that is before us now is it. We would like to talk with both of you about the surging entitlements that represent the largest portion of our budget and get your insight into that. I have to tell you, I was disappointed when OMB Director Lew and Secretary Geithner made it pretty clear that the President does not support and in effect, as I interpreted their testimony, would oppose Social Security reform. So we have got to somehow work our way through this idea that we cannot take any action on entitlements, and I look forward to working with my colleagues to the end that will bring our financial house in order, put us on a foundation that will lead to prosperity and job growth.

Thank you.

Chairman CONRAD. Thank you, Senator Sessions.

Now we will go to our witnesses. Senator Domenici, please proceed. Then we will go to Dr. Rivlin.

STATEMENT OF THE HONORABLE PETE V. DOMENICI, CO-CHAIR, BIPARTISAN POLICY CENTER'S DEBT REDUCTION TASK FORCE

Hon. DOMENICI. Mr. Chairman and Ranking Member Sessions, fellow Senators that are here that are members of the Committee, first I want to ask if my voice—is it all right? Can you——

Chairman CONRAD. Yes, we can hear you very well.

Hon. DOMENICI. All right. I am sorry that it has—maybe it is just old age setting in, but something is wrong this morning. It is not going too well.

First, I am very glad to see all of you. Those of you whom I know, it is a pleasure to be back with you. To the new Senators, it is truly a pleasure. We always had new Senators on this Budget Committee, two or three most of the time, and you would be surprised by the great commitment they had and the kinds of success they brought to this Committee by their efforts. And I hope you see that and have the pleasure of taking some real steps as members of this Committee.

I am glad to be back. As you probably know, I have been retired for just over 2 years, and strangely enough, I was forbidden to come and lobby before you for the first 2 years. They found that even though I would be here talking about our country's problems, that was lobbying. So I stayed away for a while and just handed in a few papers here and there as to what we were doing, but I am very glad to be here now.

During the decade since the Federal Government last balanced the budget, our country's fiscal responsibility has taken a dramatic turn for the worse. "Alarm bells should be ringing very loud in Washington." That is a quote from fiscal historian Niall Ferguson. I will repeat it. "Alarm bells should be ringing very loud in Washington." That is what should be happening here.

We are testifying before the Committee today not just to add our voices to the choir and the chorus that has been warning you of this danger but, rather, we are here to highlight our battle scars

from budget fights of the past and to illuminate a bipartisan path forward to address the looming crisis facing our Nation. Countries around the world have seen their bonds downgraded by credit rating crises. The agencies that do this have downgraded some.

Thankfully, we have benefited from our standing as the world's reserve currency, providing us with low interest rates and stable credit status. Recent Treasury data seems to show, however, that China is already slowing its acquisition of American sovereign debt. Simply put, we do not know when our time will come. We do not know when our time will come.

I am worried more about America's future today than at any other time in my life. I served for 36 years, have been retired for two. That means 38 years. And I repeat, I am more worried about our future now than I have been at any time in my adult life when I served here in the Senate.

The chart that you see boils it down to simple reality. If we do not act soon, America will be on the path to ruin. They should write the word "ruin"—R–U–I–N—at the top of that chart because economic catastrophe awaits us if we do not dramatically alter the course of that line. It is a very simple line, and, frankly, it is true. It happens. It is the path we are on. It cannot be taken off that blackboard unless you have a master plan for changing what causes that line to be what it is.

Near the beginning of the next decade, American debt held by the public will eclipse the size of our entire economy. Most forecasters do not believe that we have anywhere near that long before the market adjusts and demands significantly higher interest rates for U.S. Treasuries, which at our level of indebtedness could spark an uncontrollable downward spiral. Fiscal crises have taken down nations in the past and will do so in the future. The question is: Will America be the next nation to fall victim to the fiscal follies? You have to answer that, and I am sure that if you answer it in the affirmative, you will consider yourself bound by some new and extraordinary responsibility to do something for your country.

The debt is something that we do not see on a daily basis. We do not think about it as we watch Sunday football games, as we take our children to school. It is a silent killer, slowly eating away at society's value, at those things which we value. But if we continue to ignore it, then when the market responds—and we know at some point it will—the time frame for measured action will be past, and we will be forced into a world of pain, and there is no doubt about it.

Unfortunately, President Obama has been largely absent from this conversation. While his budget for next year does propose restraint in domestic discretionary spending, he neglected to lay out a vision for seriously dealing with our long-term debt problem. Perhaps even more importantly, the President thus far has failed to adequately emphasize to the American people the scope of this massive looming problem that awaits them and threatens to destroy much of what they hold dear.

I am here as a lifelong Republican, but a terribly concerned American citizen is what brings me to this podium. And I would say what I just said about our President, I would say that if he were a Democrat—if he were a Republican, excuse me. "Mr. Presi-

dent, we need you to lead in this critical time period." That is what I would say to the President. "We need you to say, 'I'm not going to let this happen on Americans' watch.' If and when you do, I am for standing behind you, walking with you to solve this problem."

The Bipartisan Policy Center Task Force that I co-chaired with Dr. Alice Rivlin has already presented a solution to both Democrats and Republicans, and Republicans and Democrats stand proudly together behind this very clear, principled program. Our task force is not liberal and not a conservative group. We are 19 men and women, Americans. We are committed to addressing our problem. We all agreed to sit down, discuss, negotiate, and produce a plan.

These 19 people did hard work, committed themselves to saving the country as they saw it, and the sum total of this package that every single member feels they can support for the good of our country. That is what it is.

Second, we came to the inescapable conclusion that neither revenue increases nor spending cuts alone could extricate us from this. But believe me, I would not be here before you today with a package that includes new revenues if we could solve this problem with reasonable reductions in expenditures. But I have looked at the math and the arithmetic, and it is simply not feasible. Others in our group would strongly have preferred a much larger contribution from the revenue side. They realized, however, that measured tax increases on the wealthy Americans would barely make a dent in our problem.

Our third guiding principle was that everything must be on the table. We need a comprehensive agreement. We witnessed in our task force that members were reluctant to agree to policies that they disliked unless they saw those on the other side contributing and making sacrifices in other areas. Politically, we all know that entitlements and revenues are hard to even look at, but the sheer size of this debt requires that we leave no stone unturned.

Last but not least, we saw the need for a long-term plan to be enacted soon. Our debt has now built up overnight—excuse me. It has not built up overnight, and it will not be fixed overnight. But it must be fixed in a plan. It cannot be fixed piecemeal. You can nibble away at the edges, but it cannot be fixed piecemeal. It has to be fixed by a comprehensive plan.

And last but not least, we saw the need for this long-term plan to be enacted soon. Our debt, was not built up overnight, it cannot be fixed overnight. It is a long-term problem, and the sheer magnitude requires that we resolve to enact a far-reaching and persistent solution. Our creditors and the American people are waiting to see a lasting change. We decided to gradually phase in proposals because the economy is still fragile. But we stressed the importance of enacting a plan as soon as possible, a broad solution that would be the best imaginable stimulus for our economy. It would spur growth and help our economy continue to create jobs in the coming years.

I want to repeat that. A broad solution would be the best imaginable stimulus for our economy. It would spur growth and help our economy continue to create jobs in the coming years.

The plan we present to you today will reduce annual deficits to manageable levels and will keep it there, stabilize the debt below

60 percent of GDP within a decade. With medical costs representing the heaviest driving force and forces behind our deficit, Medicare comprising a large portion of the Federal Government's health spending, the task force decided after much deliberation on a premium support system. We looked at the annual domestic and defense appropriated accounts. We must realize that even if we were to entirely eliminate domestic discretionary spending—let me repeat. If we were to entirely eliminate domestic spending, that is, the appropriated accounts, the United States would still face significant deficits for as far as the eye can see. Cutting this section of the budget produces some of the biggest pain for the littlest gain, but its restraint must be part of the solution. No question about it.

In addition, defense must no longer be sacrosanct, particularly in light of Admiral Mullen's comments, which you have emphasized here this morning. We can and we must find efficiencies and savings while still maintaining our position as the great global power.

Although Social Security will be discussed separately from our debt problem, all our members, including Bill Novelli, former CEO at the AARP, who served on our task force, agreed that the program is in need of adjustments to ensure that it remains strong for future generations. We have proposed a package that would ensure its solvency for the next 75 years and beyond. And if you are interested in a package that does that without changing the age of retirement, we have one. It is good enough to do that.

Addressing our debt problem gives our Nation a much needed opportunity to review our arcane Tax Code and dramatically overhaul it. That is interesting to note. With all the bad, there is some good. If we do intend to put a package together, the Tax Code stands out there as something to be taken on and to be solved.

Our task force included tax experts. We were delighted to have them. They asked us for extra time so they could produce a plan, and they thought they could and they did. If you ever want to see a great tax plan to get rid of the tax loopholes, lower the threshold on income tax, have just two brackets—the highest being 27, and lower the corporate to 27, and then having two expenditures, one for the working poor and one for children of poor families, you build those in. And then on top of that you add a 6.5-percent debt reduction tax, and lo and behold, you have a budget that will solve America's problems without any doubt. It will reduce—when all is said and done, we will cut $7 trillion out of our projected debt obligations for the coming decade and have achieved an even balance between spending cuts and revenue increases. That seems somewhat fair.

Mr. Chairman and Ranking Member and other Senators who have been good enough to come to listen today, I am of the impression, believe it or not, that this could be done this year. If you and your colleagues have the will, a multi year bipartisan budget plan can be adopted by means of the Budget Impoundment and Enforcement Act or a massaged version of it. I call on all of you to set partisan interests aside and put the fiscal house of your Government in order.

Indiana Governor Mitch Daniels voiced this sentiment best when he said—and I do not know why I chose him except I like the way

he is talking about this thing, so I chose one of the candidates on my side of the aisle to quote. He said, and I quote, "I have no interest in standing in the wreckage of the Republic and saying, 'I told you so' or 'You should have done it my way." That is the end of the quotes.

I know well that compromise is not always pursued in this body, nor need it always be. But I truly fear that if we do not agree on a solution to this issue soon, the economic fate of our great Republic may be sealed. We can restore America's future, regain our prosperity, and continue to be the world's leader of innovation and achievement only if we confront this problem together as a Nation.

I will now turn to my extraordinary partner, Dr. Rivlin, with whom I have been privileged to work during not only the past year but also in previous decades on momentous budget agreements. She will provide a more detailed explanation of some of the components in our plan and other important matters.

[The prepared joint statement of Hon. Domenici and Hon. Rivlin follows:]

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TESTIMONY BEFORE THE SENATE BUDGET COMMITTEE
by
Senator Pete V. Domenici and Dr. Alice M. Rivlin[1]
Co-Chairs, Bipartisan Policy Center Debt Reduction Task Force

March 15, 2011

Mr. Chairman, Senator Sessions, and Members of the Committee:

Thank you for the opportunity to testify before the Committee today.

We believe that America is facing two huge challenges that can only be surmounted if both political parties work together: recovery from the recession and restraining the soaring federal debt. We also believe that these two challenges must be addressed simultaneously.

The federal budget is on a dangerous, unsustainable path. Even after the economy recovers from this deep recession, federal spending is projected to rise substantially faster than revenues and the government will be forced to borrow ever-increasing amounts. Without policy changes, federal debt will rise to unmanageable levels, which will push interest rates up, endanger our prosperity, and make us increasingly vulnerable to the dictates of our creditors, including nations whose interests may differ from ours.

This alarming prospect was created by the actions of both political parties over many years, with strong public approval. Promises to provide benefits and services through Medicare, Medicaid, Social Security and many other spending programs, as well as reductions in taxes, were extremely popular and both parties took credit for them. But now, with an aging population and increasingly expensive health care, federal spending will rise much faster than revenues if those popular policies are not changed.

However, the actions needed to reduce the growth of national debt and bring deficits back to manageable levels are all unpopular. Neither party can take the required actions alone without suffering adverse political consequences. The only hope is for the two parties to come together around a bipartisan plan – which liberals, moderates, and conservatives alike see as fair – and work together to make it a reality.

On January 25th, 2010, the Bipartisan Policy Center – founded by former Senate Majority Leaders Howard Baker (R-TN), Tom Daschle (D-SD), Bob Dole (R-KS), and George Mitchell (D-ME) – launched a Debt Reduction Task Force to develop a long-term plan to

[1] The views expressed in this statement do not necessarily reflect those of staff members, officers, or trustees of the Brookings Institution.

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reduce the debt and place our nation on a sustainable fiscal path. The BPC asked us to co-chair the Task Force and we were honored to accept.

The two of us share strong beliefs that America must learn to live within its means, that the current budget path endangers the future of our country, and that bipartisan action is urgently needed. Each of us played a significant role in the successful bipartisan efforts that brought the federal budget into surplus for four years in a row starting in the late 1990s and reduced the debt held by the public.

We know from personal experience that bipartisan budget agreements are extremely difficult to create – neither side gets what it wants – but they are possible. The budget outlook is even more threatening today than it was then, and we hope that our political leaders will see the urgency of working together to take the difficult actions now to restore America to economic health.

Our Task Force – 19 Americans from across the country, with diverse backgrounds and views – examined a broad range of spending and revenue options for the federal government. On November 17 2010, we released our plan, "Restoring America's Future." It provides a comprehensive, viable path to restore our economy and build a stronger America for future generations.

To arrive at consensus on a plan of this size and complexity, each of the Task Force members made significant compromises. To be sure, not every member agreed with every element of this plan. But, each member agrees on the urgency of economic recovery and stabilizing the debt and believes that, as a whole, this plan offers a balanced, effective, and reasonable approach to the twin challenges at hand. Perhaps most importantly, the plan demonstrates that at this time of political uncertainty, a bipartisan group can craft a comprehensive and viable blueprint to tackle the nation's most serious economic challenges.

Mr. Chairman, Senator Sessions, and Members of the Committee: The congressional budget process gives you the means, at this critical moment in history, to adopt a comprehensive debt stabilization plan. You have only to summon the political will and utilize the Budget Resolution and Budget Reconciliation process that are at your disposal.

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The Twin Challenges of Strengthening the Recovery and Stabilizing the Debt

America is the strongest, most prosperous, and most resilient nation in history. However, America's leadership and greatness, our strength and prosperity, are not guaranteed. We face two huge challenges simultaneously.

First, we must recover from the deep recession that has thrown millions out of work, slashed home values, and closed businesses across the country.

Second, we must take immediate steps to reduce the unsustainable debt that will be driven by the aging of the population, the rapid growth of health care costs, exploding interest costs, and the failure of policymakers to limit and prioritize spending.

These two challenges must be addressed at the same time, not sequentially. We need immediate action to sustain the recovery and create jobs, but we cannot delay putting in place measures that will restrain the buildup of debt. If we do not control the debt, the recovery will not be sustainable.

With current policies in place, the debt is slated to grow far larger than the economy itself, forcing the nation to borrow enormous and unprecedented sums of money, increasing our dependence on China and other foreign lenders, diminishing our living standards, raising risks of an economic crisis, and reducing America to a second-rate power.

At stake are both our economic security and our national security. Federal Reserve Chairman Ben Bernanke warns that threats to our economy are "real and growing" and that our path is "unsustainable" because, at some point, our creditors would refuse to lend to us. Chairman of the Joint Chiefs of Staff, Admiral Michael Mullen, calls the debt "the single biggest threat to our national security."

That's why we face a fundamental choice:

We can close our eyes, keep avoiding the problem, and generate more debt that will threaten our economy, mortgage our children's future, and diminish our leadership around the world.

Or, we can choose a new course – one that can revive our economy, create new and better jobs, restore our financial independence, and ensure that America remains the world's preeminent economic, military, and political power. The Task Force report, "Restoring America's Future," is a plan for that new course that we believe would meet both the short- and the longer-run challenges simultaneously.

The Bipartisan Policy Center's Task Force members were former White House and Cabinet officials, former members of Congress, former governors and mayors, business

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and labor leaders, economists and budget experts: Democrats, Republicans, and Independents – Americans from across the country, with widely diverse views about public policy and the role of government.

The Task Force members understood that the key to stabilizing the debt begins with a strong economy that reignites demand for goods and services and encourages businesses to invest and create jobs.

Currently, millions of Americans cannot find jobs or are underemployed. That's why this bipartisan plan calls for ***fully*** suspending Social Security payroll taxes for one year – called a "payroll tax holiday" – which would immediately add money to employee paychecks while incentivizing companies to hire new workers.

The partial tax holiday enacted in December is on the right track, but insufficient – particularly with rising energy prices and the reduction of state and local government spending.

A full $640 billion payroll tax holiday would provide a big shot in the arm to revive our economy and create jobs.

At the same time, we must restore optimism about the economy's future in order to boost investment. A comprehensive debt-reduction package would assure investors worldwide that America is back on track, with a solid plan and a stable economic future.

In that regard, the plan aims to reduce and stabilize the national debt below 60 percent of the gross domestic product (GDP) – an internationally recognized standard – by 2021 and ensure that the debt stops growing faster than our economy.

The plan also would balance the "primary budget," the budget other than interest payments, by 2014. On a "unified budget basis" (i.e., including interest), the plan would ensure that future budget deficits are small and manageable.

But, above all, it would ensure a strong economy for future generations of Americans.

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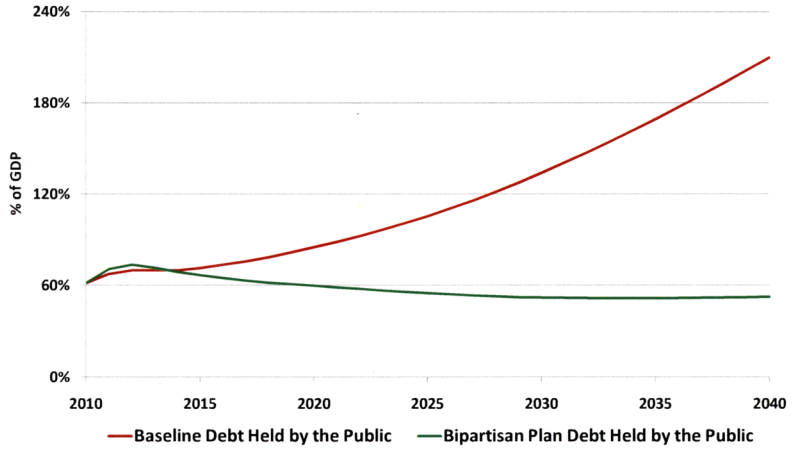
Debt Drops Dramatically Under Bipartisan Plan



Source: CBO's "Alternative Fiscal Scenario" constructed from the August 2010 Budget and Economic Outlook, additionally assuming that troops in Iraq and Afghanistan are reduced to 30,000 by 2013.

Our Growing Debt and the Risks of Inaction

Without action, growing deficits and debt will create serious problems for our economy, our prosperity, and our leadership role in the world.

First, the higher the debt, the more interest we have to pay. At the moment, interest rates are at historically low levels because of our weak economy and because the fiscal problems of other countries leave investors around the world few attractive alternatives to U.S. Treasury securities. But as our economy recovers and other nations address their problems, interest rates will return to higher levels, which will increase interest costs on our debt significantly.

In 2022, the federal government will pay $1 trillion – 16 percent of all federal spending – just for interest payments. Viewed another way, the federal government would have to allocate about half of all income tax receipts to pay interest, and interest payments would exceed the size of the entire defense budget.

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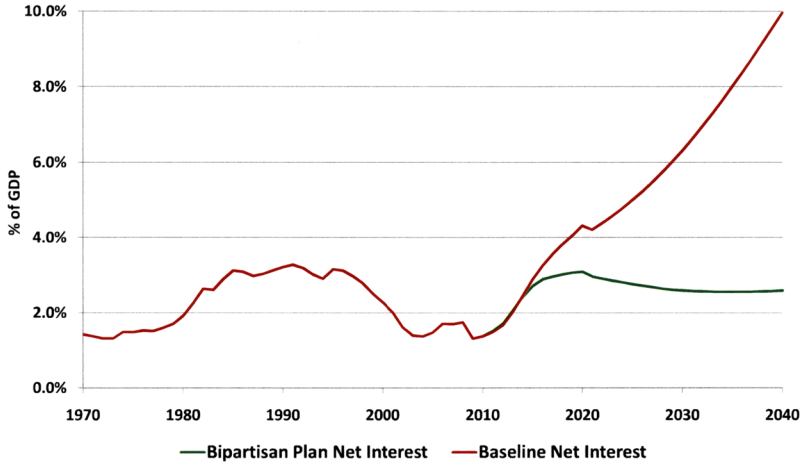
Net Interest Payments Drop Dramatically Under Bipartisan Plan



Source: CBO's "Alternative Fiscal Scenario" constructed from the August 2010 Budget and Economic Outlook, additionally assuming that troops in Iraq and Afghanistan are reduced to 30,000 by 2013.

Moreover, by 2025, without a dramatic change in fiscal policy, federal revenues will be completely consumed by the combination of interest payments, Medicare, Medicaid, and Social Security. The Treasury will have to borrow money to finance all of its other obligations – including defense, homeland security, law enforcement, food and drug inspection and other vital operations.

These projections are based on fairly moderate assumptions about future interest rates. The nation's outlook will grow far more ominous if America's creditors lose confidence in the federal government's commitment to address its debt problem – which would increase interest rates. A loss of confidence in the markets could also send the value of the dollar plunging overseas, which could trigger runaway inflation and still higher interest rates.

Rising debt and rising interest costs could evolve into a "death spiral," with the two feeding off one another in an ever-more vicious cycle. No one knows when such a catastrophe might occur, but no prudent nation would put itself at such risk.

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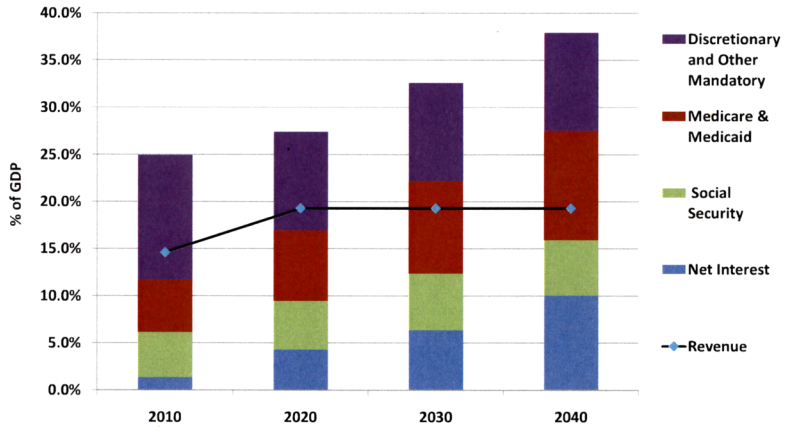
Even without a crisis, rising debt will increase our reliance on foreign lenders, raising a host of other economic and national security issues. Already, more than half of U.S. federal debt is foreign-owned and China is the largest foreign holder.

Revenues Completely Consumed by Major Entitlements and Interest by 2025



Source: CBO's "Alternative Fiscal Scenario" constructed from the August 2010 Budget and Economic Outlook, additionally assuming that troops in Iraq and Afghanistan are reduced to 30,000 by 2013.

Rising deficits and debt will weaken the nation in other serious ways as well. Federal deficits soak up private savings that would otherwise be available for investment in factories, equipment, and jobs.

At some point, without a change in policy, the federal government's out-of-control borrowing will have to stop. The only question is whether policymakers address the debt problem now in a deliberative and thoughtful manner, or whether they would be forced to do so by a sudden economic crisis.

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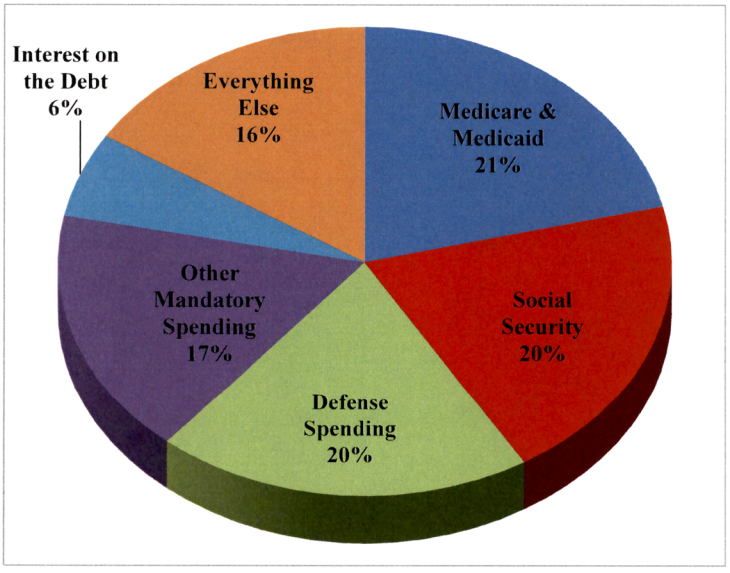
No Easy Answers

Most Americans would be reluctant to cut several key categories of federal spending. In fiscal year (FY) 2010:

- Medicare and Medicaid consumed **21 percent** of federal spending;
- Social Security consumed **20 percent;**
- Defense consumed **20 percent**;
- Other mandatory spending (for example, veterans' compensation, unemployment insurance, and food stamps) consumed **17 percent**; and
- Interest on the debt consumed **6 percent**.
- That leaves **only 16 percent** for everything else – veterans' health care, homeland security and law enforcement, education and student aid, roads and bridges, food and drug inspection, energy and the environment, and so on. Clearly, there are no easy answers to the debt crisis.



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Contrary to recent rhetoric, policymakers cannot solve the debt crisis simply by eliminating congressional earmarks (less than one percent of the discretionary budget) or foreign aid, which is less than one percent of the total budget.

Nor can policymakers significantly reduce the debt by eliminating "waste, fraud, and abuse," although they surely should undertake efforts to eliminate as much waste, fraud, and abuse as possible.

Nor can policymakers realistically solve the problem simply by cutting domestic discretionary spending. Stabilizing the debt by 2021 through domestic discretionary cuts alone would require eliminating nearly all such spending – everything from law enforcement and border security to education and food and drug inspection.

Nor can policymakers rely on hopes of a strong economy to "grow our way out of the deficit." Just to stabilize the debt at 60 percent of GDP, the economy would have to grow at a sustained real rate of more than 6 percent per year for at least the next 10 years. The economy has never grown by more than 4.4 percent in any decade since World War II.

Nor can policymakers solve the problem simply by raising taxes on wealthy Americans. Reducing deficits to manageable levels by the end of the decade though tax increases on the most well-to-do Americans would require raising the top two bracket rates to 86 percent and 91 percent[2] (from the current 33- and 35 percent rates).

There are no easy answers, no quick fixes. Following is a bipartisan, fair and reasonable plan that calls for reforms to every part of the budget and the participation of all Americans to restore America's future for our children and grandchildren.

[2] Rosanne Altshuler, Katherine Lim, and Roberton Williams, *Desperately Seeking Revenue*, Tax Policy Center, January 29, 2010, http://www.taxpolicycenter.org/UploadedPDF/412018_seeking_revenue.pdf.

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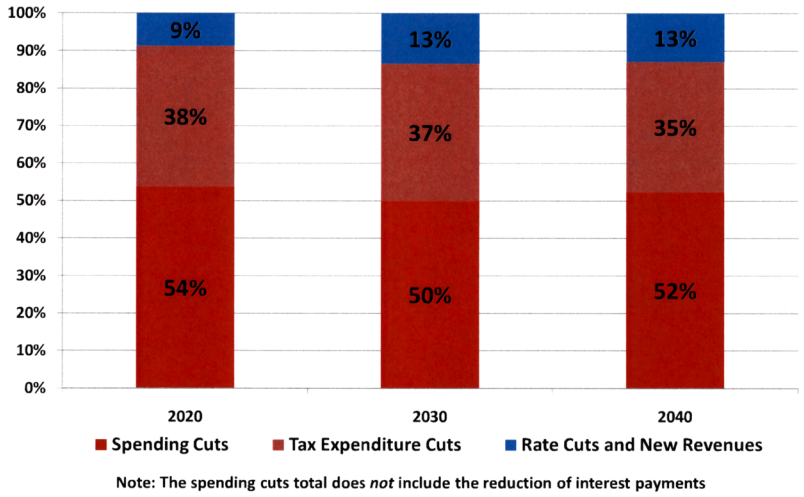
Sources of Debt Reduction in BPC Plan: Spending Cuts, Tax Expenditure Cuts, and New Revenues



Note: The spending cuts total does *not* include the reduction of interest payments

The Task Force approached its task as not just a challenge, but also as an opportunity to recommend significant and sorely needed changes to both taxes and spending.

On the spending side, our plan fixes Social Security, which is on an unsustainable path, reins in rising health care costs, and freezes both defense and domestic discretionary spending – ***without making excessive cuts that might stall the recovery.***

On the tax side, the Task Force plan dramatically simplifies taxes by eliminating years of accumulated tax preferences – allowing major tax rate reductions, while raising additional revenues to reduce the debt. Lower corporate rates would make America more competitive, and lower individual rates with a simplified tax system would give taxpayers renewed confidence that our system is fair and understandable. A Debt Reduction Sales Tax (DRST), along with the plan's spending cuts, would reduce our debt.

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Summary of Debt Reduction Task Force Recommendations

1. **Revive the Economy and Create Jobs**

   - Enact a "payroll tax holiday" for one year – excusing employers and employees from paying the 12.4 percent tax into the Social Security Trust Funds.

   - Under Congressional Budget Office (CBO) assumptions, this would **create between 2.5 and 7 million new jobs**.

   - The tax holiday would not impact the solvency of the Trust Funds, which can be reimbursed in full from general revenues at the same time that they would have received payments in the absence of the holiday.

2. **Reduce and Stabilize the Debt**

   - By 2021, reduce and stabilize the federal debt below 60 percent of GDP, an internationally recognized standard for fiscal stability, and reduce annual budget deficits to manageable levels.

   - The plan would balance the primary budget (the budget other than interest) by 2014.

   - On a "unified budget basis," which includes interest, the plan would ensure that future budget deficits are small and manageable. But, above all, it would ensure a strong economy for future generations of Americans.

   - Reduce federal spending from a projected 26 percent of GDP to 22.3 percent by 2021, with revenues at 21.7 percent.

   - These fiscal changes would enable the Federal Reserve to hold interest rates down longer in order to strengthen the economic recovery.

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3. **Create a Simple, Pro-Growth Tax System**

- Cut tax rates; broaden the tax base; boost incentives to work, save, and invest; and ensure, by 2018, that nearly 90 million households (about half of potential tax filers) no longer have to file tax returns.

  - ✓ Cut individual income tax rates and establish just two rates – 15 and 27 percent – replacing the current six rates that go up to 35 percent.
  - ✓ Cut the top corporate tax rate to 27 percent from its current 35 percent, making the United States a more attractive place to invest.
  - ✓ Eliminate most deductions and credits and simplify those that remain while making them better targeted and more effective.
  - ✓ Replace the deductions for mortgage interest and charitable contributions with 15 percent refundable credits that anyone who owns a home or gives to charity can claim.
  - ✓ Restructure provisions that benefit low-income taxpayers and families with children by making them simpler, more progressive, and enabling most recipients to receive them without filing tax returns.

- Establish a new 6.5 percent national Debt Reduction Sales Tax (DRST) that, along with the spending cuts outlined in this plan, would reduce the debt and secure America's economic future.

- These reforms, taken together, would make the tax system more progressive.

4. **Restrain Rising Health Care Costs** (Savings through 2021: $1.1 trillion, excluding interest)

- Incentivize employers and employees to select more cost-effective health plans:

  - ✓ Cap the exclusion of employer-provided health benefits in 2018, and then phase it out over 10 years.

- Control Medicare costs in the short term:

  - ✓ Gradually raise Medicare Part B premiums from 25 to 35 percent of total program costs (over five years).

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- ✓ Use Medicare's buying power to increase rebates from pharmaceutical companies.
- ✓ Modernize Medicare's benefits package, including the copayment structure.
- ✓ Bundle Medicare's payments for post-acute care to reduce costs.

- Preserve Medicare for the long term:

  - ✓ Transition Medicare, starting in 2018, to a "premium support" program that limits growth in per-beneficiary federal support (to GDP-plus-1 percent, as compared to current projections of GDP-plus-1.7 percent). The new system would maintain traditional Medicare as the default, but would charge higher premiums if costs rise faster than the established limits. Alternatively, beneficiaries could opt to purchase a private plan on a health insurance exchange. Competition among plans should improve the quality of care and increase efficiency.

- Control Medicaid costs in the short term:

  - ✓ Apply managed care principles in all states to aged Supplemental Security Income (SSI) beneficiaries.

- Control Medicaid costs in the long term:

  - ✓ Beginning in 2018, reduce the amount by which Medicaid is growing faster than the economy (that is, reduce annual per-beneficiary cost growth by 1 percentage point).
  - ✓ There are various approaches to achieving these savings. One option would be to reform the shared financing arrangement between the federal and state governments, which has led to gaming of the matching payment system and rising health care costs. Through a federal-state negotiation, allocate program responsibilities between the federal government and the states, so that each would fully finance and administer its selected components of the Medicaid program. This would restore incentives for cost containment, and slow future program spending growth.

- Reform medical malpractice laws:

  - ✓ Cap awards for noneconomic and punitive damages for medical malpractice.
  - ✓ Start large-scale testing of systemic reforms, including safe harbors for practices that conform to accepted guidelines, specialized malpractice courts, and administrative proceedings to resolve disputes.

- Help reduce long-term health care spending to treat obesity-related illnesses – including diabetes, heart disease, cancer, and stroke – by imposing an excise tax on the manufacture and importation of beverages sweetened with sugar or high-fructose corn syrup.

- The Task Force plan accommodates a permanent fix to the sustainable growth rate (SGR) mechanism that currently requires unrealistic automatic cuts in physician payments (which Congress has been annually delaying).

5. Strengthen Social Security

In order to guarantee that Social Security can pay benefits for the next 75 years and to restrain the impact of the baby boom generation on our growing public debt:

- Gradually raise the amount of wages subject to payroll taxes (currently $106,800) over the next 38 years to reach the 1977 target of covering 90 percent of all wages.

- Change the calculation of annual cost-of-living adjustments (COLAs) for benefits to more accurately reflect inflation. (This is a technical change that would be applied in all government programs that use COLAs, including the indexation of tax brackets.)

- Slightly reduce the growth in benefits compared to current law for approximately the top 25 percent of beneficiaries.

- Increase the minimum benefit for long-term, lower-wage earners, and protect the most vulnerable elderly with a modest benefit increase. The former is particularly targeted to address the needs of long-time laborers who are unable to remain in

the workforce due to the demanding nature of their work.

- Beginning in 2023, index the benefit formula for increases in life expectancy and require the Social Security Administration to ensure that early retirees understand that they are opting for a lower monthly benefit. These changes would increase the incentive to work longer, while not changing either the age of full retirement or the early retirement age from those in current law.

- Cover newly hired state and local government workers under the Social Security system, beginning in 2020, to increase the universality of the program.

6. **Freeze Domestic Discretionary Spending** (Savings through 2021 compared to CBO baseline: $338 trillion, excluding interest)

   - Freeze domestic (i.e., non-defense) discretionary spending for four years at 2011 levels and cap at GDP thereafter.

   - Implementing the freeze would require policymakers to terminate ineffective programs and set priorities across the broad range of government programs. Savings can also be achieved through adopting state and local best practices, modernizing the federal government's regional office structure, and sharing human resources, procurement, and other services across federal agencies.

   - Enforce the freeze through statutory spending caps, which, if exceeded, trigger automatic across-the-board cuts in all domestic discretionary programs.

7. **Freeze Defense Spending** (Savings through 2021 compared to CBO baseline: $440 billion, excluding interest)

   - Freeze defense discretionary spending for five years and cap at GDP thereafter (baseline assumes reduction of troop levels deployed in combat to 30,000 by 2013).

   - Among the options for achieving the required savings are streamlining military end strength, prioritizing defense investment, maintaining intelligence capabilities at a reduced cost, reforming military health care, and applying the savings from Secretary Gates' efficiency measures to deficit reduction.

- Implement the freeze through statutory spending caps, enforceable through automatic across-the-board cuts in all defense programs.

8. **Other Savings** (Savings through 2021: $106 billion, excluding interest)

   - Reduce farm program spending by eliminating all farm payments to producers with adjusted gross incomes greater than $250,000, imposing limits on direct payments to producers, consolidating and capping 16 conservation programs, and reforming federal crop insurance.

   - Reform civilian retirement by calculating benefits based on a retiree's annual salary from his or her highest five years of government service; and reform the age at which career military can retire to be consistent with federal civilian retirement.

   - Achieve other cost savings by raising fees for aviation security, actuarially adjusting flood insurance subsidies for risk, adjusting Pension Benefit Guaranty Corporation fees to better cover unfunded liabilities, and adopting a more accurate inflation measurement to calculate COLAs for all federal programs.

9. **Enforce the Budget, Reform the Process**

   - Enforce the four-year domestic discretionary freeze and the five-year defense discretionary freeze, and the limits in annual growth in the years thereafter, by imposing statutory caps on both categories of spending.

     ✓ Exempt emergency spending from the caps – but strictly limit such emergencies to specific situations, subject to certification by the President and Congress.
     ✓ Require the Office of Management and Budget (OMB), by law, to impose across-the-board cuts in all programs within the relevant category (i.e., domestic or defense programs) if spending exceeds the caps in any fiscal year.

   - Prevent new tax cuts or new entitlement spending from worsening the fiscal situation by enacting a strict, statutory "pay-as-you-go" (PAYGO) requirement:

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- ✓ Require policymakers to fully offset new tax cuts, expansions of existing mandatory spending, or new mandatory spending with increases in revenues or reductions in mandatory spending.
- ✓ Trigger fully offsetting automatic cuts in predetermined mandatory programs if policymakers violate the requirement.

- Convert the federal budget process from annual to biennial budgeting.

- Enact explicit long-term budgets for the major entitlement programs.

  - ✓ Create a Fiscal Accountability Commission that would meet every five years to assess whether program growth is remaining within the long-term budgets and, if not, to propose measures to restore long-term sustainability.

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Jason S. Grumet, President

Bipartisan Policy Center (BPC) Tax Reform
Quick Summary

The Bipartisan Policy Center (BPC) Tax Reform Plan represents a radical simplification of the current tax code. In fact, to best explain it, forget what you know about the complexities of the current tax system, and start fresh. Outlined below are the core elements of the plan:

- A **two-bracket income tax with rates of 15 percent and 27 percent**. Because there is no standard deduction or personal exemptions, the 15 percent rate applies to the 1st dollar of income.[3]

- The **corporate tax rate would be set at 27 percent**, instead of the current 35 percent level.

- Capital gains and dividends would be taxed **as ordinary income (with a top rate of 27 percent)**, excluding the first $1,000 of realized net capital gains (or losses).[4]

- Introduce a **6.5 percent broad-based Debt Reduction Sales Tax (DRST)**, phased-in over two years.[5]

- To replace the overly complex Earned Income Tax Credit (EITC) and to help offset the effects of the DRST and elimination of personal exemptions, the standard deduction and the child credit, the BPC Plan would establish:
    - A flat **refundable per child tax credit of $1,600** (higher than current law); and
    - A **refundable earnings credit**[6] similar to the current Making Work Pay credit, but substantially higher.

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[3] The 27 percent rate applies approximately to income above $51,000 for single filers and $102,000 for couples.
[4] $500 for singles and heads of household
[5] The DRST would start at 3 percent in 2012, and then increase to 6.5 percent by 2013.
[6] The refundable earnings credit is equal to 21.3 percent of the first $20,300 of earnings.

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- Instead of the current system of itemized deductions, which disproportionately subsidizes the housing consumption and charitable giving of upper-income taxpayers, the BPC Plan would:
    - Provide a **flat 15 percent refundable tax credit for charitable contributions** and for up to $25,000 per year, not indexed, **mortgage interest on a primary residence**.
    - Eliminate the deduction for state and local taxes.
    - Provide a flat, **15 percent refundable tax credit** or a deduction (for those in the higher bracket) **for contributions to retirement saving accounts** up to 20 percent of earnings or a maximum of $20,000.

- Include 100 percent of Social Security benefits in taxable income, but:
    - Create a non-refundable credit for Social Security beneficiaries equal to 15 percent of the current standard deduction; and
    - Create a non-refundable credit equal to 15 percent of an individual's Social Security benefits.

- Allow deduction of medical expenses in excess of 10 percent of Adjusted Gross Income (AGI) (as in current law).

- Allow deduction of miscellaneous itemized deductions in excess of 5 percent of AGI.

The BPC Plan achieves a massive simplification of the tax code:

- **Aligns the top individual, capital gains and dividend tax rates**
- **Reduces the corporate tax rate**
- **Eliminates the AMT**
- **Eliminates the need to file returns for most individuals**[7]

Despite a low top rate of 27 percent, the new tax system created under the BPC Plan is **more progressive than the current system** and **raises the requisite revenue to achieve our debt-reduction goal**.

[7] According to Tax Policy Center projections, only 50 percent of tax units would be required to file tax returns, as opposed to 88 percent under the current tax system.

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About the Bipartisan Policy Center

In 2007, former Senate Majority Leaders Howard Baker, Tom Daschle, Bob Dole and George Mitchell founded the Bipartisan Policy Center (BPC), a non-profit organization that develops and promotes solutions that draw support from both Republicans and Democrats and generates the necessary political momentum to achieve real progress. As the only Washington-based organization promoting bipartisanship as an effective means of overcoming the challenges facing the nation, the BPC is working to restore civility and respectful discourse to the national debate.

The BPC currently has projects focused on health care, energy, national and homeland security, economic policy, and transportation. Each of these initiatives is headed by a diverse team of political and business leaders, substantive experts and academics who work closely with our staff of policy specialists and former Congressional and White House aides to develop consensus-based solutions that both Republicans and Democrats can support. The Bipartisan Policy Center Action Network, the BPC's c(4) organization, provides strategic advice and political advocacy to ensure our projects' policy recommendations have traction in Congress, the Executive Branch and the stakeholder community.

We believe it's time to revive the nation's longstanding bipartisan tradition – a tradition that in the last century produced significant achievements in energy and environmental policy, Social Security reform, and national security. Through events like Bridge-Builder Breakfasts, political summits and timely policy discussions, the BPC provides a forum to highlight policymakers and political leaders who are working collaboratively to forge bipartisan consensus on the key issues of the day.

1225 Eye Street NW, Ste. 1000 Washington, DC 20005 Tel: 202-204-2400 Facsimile: 202-637-9220

Jason S. Grumet, President

Chairman CONRAD. Dr. Rivlin, welcome.
Hon. DOMENICI. Thank you, Senators.
Chairman CONRAD. Thank you, Senator Domenici.
Dr. Rivlin.

STATEMENT OF THE HONORABLE ALICE RIVLIN, PH.D., CO-CHAIR, BIPARTISAN POLICY CENTER'S DEBT REDUCTION TASK FORCE

Hon. RIVLIN. Thank you, Mr. Chairman. I am delighted to be here, and I want to commend you particularly for your leadership on this issue over the years. The Simpson-Bowles Commission, on which I was privileged to serve with you, would not have happened if you and Senator Gregg had not taken the initiative and kept pushing until it happened.

My good friend and co-chair of the Debt Reduction Task Force, Senator Domenici, has done an excellent job of laying out the scope of the debt crisis, as did you in your introduction, facing America if we fail to curb the unsustainable growth of this Nation's public debt. I agree with everything he said, though he was a little more rough on the President than I would be. [Laughter.]

Hon. RIVLIN. The United States cannot go on borrowing at projected rates. Future spending is driven by commitments made to older people by both parties over the years. In the long run, debt cannot be contained without slowing the growth of health care spending nationally, reforming the incentives built into Medicare and Medicaid, and putting Social Security on a firm fiscal foundation for future retirees.

However, since retirement program reforms can only be made slowly, we must also cap defense and non-defense discretionary spending, restrain other mandatory programs, and restructure the Tax Code to raise more revenue. All parts of the budget must be part of the solution to this challenge.

Today I want to focus on the positive aspects of our situation. The fact that the urgent necessity to reduce future debt is also a major opportunity to make our Government operate more fairly and effectively. For too long, we have added spending programs, domestic and defense, that were intended to further worthwhile objectives without examining whether the money was effectively spent, whether program objectives overlapped with each other, whether lower-priority spending could be weeded out to make room for higher-priority objectives.

The political obstacles to undoing the damage are formidable because each spending program and each tax provision has beneficiaries and defenders. But now we face the prospect of debt crisis and economic disaster if we do not act, and this prospect may provide the impetus and the political cover for long overdue overhauls of both domestic and mandatory spending as well as the Tax Code.

I will focus on three examples: using discretionary spending caps to increase the effectiveness of federal programs; reforming Medicare to slow cost growth and introduce a controllable Medicare subsidy; and using the opportunity, as Senator Domenici has emphasized, to reform the Tax Code to make it simpler and more pro-growth while reducing rates to make America more competitive.

On discretionary spending, our task force recommended zero growth in nominal non-defense discretionary spending for 4 years—that is, a hard freeze—and growth in line with GDP afterwards. This stringency is an opportunity to rethink Federal activities and focus spending on the most effective and highest-priority programs while eliminating and combining others and making room for needed investments. Our task force report provides an illustrative list of programs recommended for cutting by recent administrations and others, and a recent GAO publication details the remarkable overlap and duplication among Federal programs with the same general objectives.

Similarly, our task force recommended freezing nominal defense spending, excluding current war spending, which is assumed to decline as the wars unwind, for 5 years followed by a cap at GDP growth. We believe that the United States could maintain an overwhelming force with capabilities sufficient for any likely contingency within this constrained spending limit if we were willing to make aggressive efforts to streamline the force and emphasize efficiency.

Building on efficiencies recommended by Secretary Gates, we suggest options for increasing effectiveness and saving money, including a somewhat smaller active-duty force, eliminating some major and minor hardware programs, reducing duplication in intelligence, and imposing greater cost sharing on TRICARE.

As to Medicare reform, Medicare is still a largely fee for-service system in which the Government is obligated to pay the bills presented for specified services to eligible beneficiaries. There are few incentives built into the system for providers to deliver care efficiently or effectively, and costs vary widely from one provider and area to another. And the Government has no way to restrain the total costs of the program. So there are major opportunities here.

The Affordable Care Act passed last year includes important provisions aimed at improving health outcomes and reducing cost growth. But the impact and timing of these efforts is still uncertain. Therefore, our task force recommended several cost-saving Medicare reforms in the short run, followed by a gradual transition of Medicare to a premium support program which would incent efficient delivery while controlling the rate of growth of Medicare costs.

To do that, we propose that, beginning in 2018, Medicare beneficiaries would have a choice of remaining in fee-for-service Medicare or going to a Medicare exchange where they could choose among alternative plans. The private health plans would receive a lump sum payment, risk adjusted for age and health status of the beneficiaries, and would not be able to cherrypick among the beneficiaries. The growth in the subsidy for both options would be limited to the growth of GDP plus 1 percent, which is lower than the rate at which Medicare has been growing. Beneficiaries opting to remain in traditional fee-for-service Medicare would pay higher premiums to cover the difference.

We believe there are two reasons for shifting to the premium support model for Medicare. One is that a total subsidy would be controllable. That is a good reason. The other reason is that competition on a well-managed Medicare exchange can be expected to

attract beneficiaries to health plans that organize themselves to provide the most effective care at the lowest price.

And, finally, fundamental tax reform, which may be the most important. Even with aggressive spending reductions, as Senator Domenici has emphasized, our task force concluded that additional revenue would be needed to achieve debt stabilization. We saw this as an opportunity to drastically improve the Tax Code to make it far simpler and more favorable to economic growth while preserving progressivity.

Senator Domenici has described this proposal, and I will not go into the details here, although we could talk about it later. But it is, I think, a really constructive tax plan which deserves serious consideration.

And, finally, budget process reforms. Our task force plan would put in place a series of reforms to enforce budget savings and improve the budget process. We would specifically bring back discretionary caps, a mechanism which worked very well in the 1990s. The plan would bring back statutory PAYGO without exceptions in order to prevent new tax cuts or new entitlement spending from worsening the fiscal situation.

The plan also calls for converting the Federal budget process from annual to biennial budgeting to provide more certainty for Federal budget planners. And it would establish a fiscal accountability commission that would meet every 5 years to assess whether program growth is remaining within long-term projections and, if not, would propose measures to restore long-term sustainability.

I also want to underscore the conviction of the task force that these debt reduction measures should be enacted in tandem with targeted measures to strengthen our economic recovery. We proposed a payroll tax holiday to emphasize that view, but in the current context, I think it is important not to cut too fast since the recovery is still fragile.

Our overall debt reduction plan is well balanced, as displayed in the chart here. It draws the savings half from spending cuts, 38 percent from cuts in tax expenditures, and only 9 percent from net new revenues.

In closing, Mr. Chairman and Senator Sessions, I want to underscore that the congressional budget process gives your Committee the means at this critical moment in history to adopt a comprehensive debt stabilization plan. If you have the courage and the political will, the budget resolution and budget reconciliation processes provide all the tools you need to restore fiscal responsibility.

Thank you, Mr. Chairman, and we would be glad to answer questions.

Chairman CONRAD. Let me start where you ended because, you know, it is true that a budget resolution can be a means for laying out a plan. It has got, as you know, several serious defects. Number one, we do not control policy. And so we can lay out numbers that go as instructions to the appropriators and to the Finance Committee, how much money to be raised, how much money to be spent. We cannot tell them how to do it. So that is especially difficult on the revenue side of the equation because we can say to them, "Raise more money," but we cannot say to them, "Reform the

Tax Code in a way that actually lowers rates." And so that creates a challenge.

The second problem with the budget resolution is typically budget resolutions, as you know, are for only 5 years. The vast majority of budget resolutions have been for 5 years. We really need a 10-year plan. And while we are not limited to 5 years, it has almost always been the case.

The third big problem is that the budget resolution never goes to the President for his signature. The budget, as you both well know, is purely a congressional document, and I personally believe that without the President at the table, we are not going to get a resolution to this problem. So it is an imperfect way of taking on this problem.

I personally believe that what we need is a summit that involves the President and the leadership of the House and the Senate, Democrat and Republican, to come up with a plan that will become law and will be signed by the President. Clearly, he has got to be at the table to negotiate.

A couple of other things have been said here that I think I need to respond to. There are some on this Committee who believe that Troubled Asset Relief Program (TARP) and stimulus had no value. I do not agree with that.

Hon. DOMENICI. That what?

Chairman CONRAD. That stimulus and TARP had no value.

I do not agree with that. I believe, as Alan Blinder, the former co-chair of the Federal Reserve, and Mark Zandi, the head of Moody's, have concluded, that without those two we would likely be in a depression today. I believe that. I believe without the two, unemployment would not be 9 percent; unemployment would be 15 percent. That is what their study concluded. And I believe without the two, we would have 8 million more people unemployed in this country than we do today.

TARP, of course, was begun under the previous President, not under this President. I was in the room when his Secretary of the Treasury, President Bush's Secretary of the Treasury, and the Chairman of the Federal Reserve told the leadership of Congress, Democrat and Republican, that if we did not act, there would be a financial collapse within days. I will never forget that as long as I live. And I believe the evidence they provided to us was persuasive. So I believe those steps had to be taken. Clearly, they added to debt in the short term. I have always been a deficit hawk. I have always believed deficits matter. And I believe it even more today.

So the problem that we confront is what do we do going forward. All of the bipartisan commissions have concluded that the best course is not to have sharp cuts right now, but to put in place a plan right now that does profoundly change our trajectory over the next 10 years. That is what the Fiscal Commission on which I served concluded; that is the conclusion of your commission. I think that is the right conclusion, that it is not a matter of sharp cuts in only 12 percent of the budget this year that are going to get us back on course. What is required is a comprehensive plan that deals with entitlements, that deals, yes, with domestic discretionary spending, but also with defense spending. And I want to ask you about that now.

In testimony before the Fiscal Commission, the testimony was that 51 percent of all Federal employees today are at the Department of Defense, and that does not count the contractors. Dr. Rivlin, I do not know if you were in the room when these defense analysts testified. But when I asked them, "Well, how many contractors are at the Department of Defense?" their testimony is, "We cannot tell you." I asked them, "Well, is it a security matter?" "No, not a security matter. We really do not know how many contractors there are." I said, "Can you give us a range?" They said, "One to 9 million is the range."

Now, I have supported my career—I have been on this Committee 24 years. I have supported every penny requested by every President for defense. Every penny. But after the testimony that came before the Commission—and we also see what the Secretary of Defense is doing now. He has talked about 50 percent of the expenditures of the Department of Defense are overhead. Overhead costs.

You concluded, the President's Fiscal Commission concluded, defense cannot be off the table. Could you tell us why you concluded that?

Hon. RIVLIN. Let me start with the last question. We concluded, along with many members of our task force and experts that we talked to (as well as the experts that we both listened to at the Simpson-Bowles Commission) that there is a lot of waste in the defense budget. Over the years, just like in the domestic budget, we have accumulated a lot of programs, a lot of weapons systems that often the Secretary of Defense did not propose, but Congress wanted to perpetuate because they caused a lot of jobs to be retained in the particular places. There is a potential, as Secretary Gates has said himself, for improving the efficiency with which the Defense Department operates. He has proposed some of those reforms.

So we listened to all this and decided this was really possible. We have a very large, effective defense establishment, far greater than any other nation, and threats change, but we believe that we can have a very effective and strong defense if we pare back some of the waste and some of the lower-priority spending.

Chairman CONRAD. All right.

Hon. DOMENICI. Might I say, actually this task force worried more about this issue than any other. We had outside consultants come in and tell us and particularly show us how it might be done, not that we were doing it but what the numbers were, and our numbers were a fixed number. It is frozen to that for the period of time prescribed, multi-year, and we asked what would it look like in terms of manpower, the various big ones, and obviously they said we have got to find ways to cut personnel because personnel is a very expensive part of the Federal defense budget. They showed us ways to save under their proposals, and this group of very adult people, people like the former president of Kellogg Corporation, former Secretary of Commerce, who is not going to vote for something that is going to destroy our defense. I was of the opinion that if we went through all this trouble to save our country and we lost our defense, we would be fools. So we ought to try to do both, save our defense and save our country, and we think there is room. These numbers will hurt for a while on defense, but if they

know, they can tell you more than anything else, if you tell them positively what their goal is for 2 or 3 years, they are the best at reaching it of any department in the Government. So if you told them, here is the number and that is what the hard freeze is, it is there for 4 years. They would just have to live with it. I think they could.

Contrary-wise, if you cannot use them to get more savings—here we have got to get domestic savings, but, look, we did defense also—if we do not have that, we lose a real pitchfork that helps us get others to go along with cuts in other parts of the Government.

Chairman CONRAD. Let me ask you this question, and then I will turn it over to Senator Sessions. You know, we have people who tell us, look, you should not touch revenue because this is purely a spending problem, and I would be the first to say we have got a spending problem because spending is, as a share of GDP, the highest it has been in 60 years. On the other hand, revenue is the lowest it has been in 60 years as a share of GDP. That tells me we have got a problem on both sides of the equation.

But what would you say to those who say, no, you cannot touch the revenue side?

Hon. DOMENICI. Well, there is probably no one that went to a task force such as this worried about the impact of trying to achieve our goal on the future of our economy to make sure we are not killing our vitality as we do this. And I am not impressed with those who say they know absolutely positively how much tax is enough for America and what is too much. You can look at history, all right, and say, you know, it has never been above 21 percent of GDP. But the truth of the matter is you do not know what number is absolutely right. And we are entering a period where we have an exceptionally large—because of demographics—an exceptionally large group of Americans entering the entitlement era for both Social Security and Medicare. The graph is here now. We are getting that very big build-up, and it appears to me, in order to take care of them in a reasonable manner, you have got to change the program and bring down the costs. But even then we cannot get by without some revenue increase if we want to have less bonds being floated out there to be purchased by other governments and other people.

So that is where it is, and I do not remember our percentages, but we are off the mark—if you stand firm on the historical number of 19 to 21, we are off that by some but, I am convinced, not enough to harm America's economy for the future. That is how I did my thinking.

Chairman CONRAD. All right. And let me ask you a final question because some say do not touch revenue, others say, well, do not touch entitlements. I tell you, I have heard loud and clear from people who say do not touch entitlements. You did. You reformed entitlements.

Hon. DOMENICI. You bet.

Chairman CONRAD. What do you say to those who say do not touch entitlements?

Hon. DOMENICI. Well, I will just give you a sentence.

She knows more about the details. I will just say you cannot—it is impossible to take the largest portion of a budget that is grow-

ing very, very rapidly and not address it in some way to save revenue—to save expenditures, excuse me. How can that be, that the largest component is left unscathed? That is the starting point, and then you just have to look at it and see can it be, and I think Alice says yes, it can be restrained, and she will tell you how.

Chairman CONRAD. Dr. Rivlin.

Hon. RIVLIN. I think the answer to why you cannot do it without taking entitlements on is simply, as you look ahead at the projections, the entitlements, but particularly the medical care entitlements, drive up spending faster than GDP can grow and faster than revenues could possibly grow.

Hon. DOMENICI. Right.

Hon. RIVLIN. If you do not slow the growth of entitlements, then you have to raise taxes continuously. It is not just once. You have to raise them continuously to keep up with the fact that entitlement spending is on track to grow faster than the GDP.

Now, how much can we restrain entitlements? We know that it will be very difficult to slow the growth of Medicare enough so that it does not drive out everything else. We must reform Medicare to slow the growth. Like Senator Domenici, I am not convinced that we can slow it enough to get back on a sustainable track without more revenues. But that is the dilemma. How much can we slow the growth of health care entitlements and, to some extent, Social Security? Can we slow it enough so that we can pay for it without revenue increases? I do not think so.

Chairman CONRAD. Senator Sessions.

Senator SESSIONS. Thank you, Mr. Chairman.

I would just say with regard to the stimulus, we have somewhat of a disagreement. Gary Becker, a great Nobel Laureate economist, warned that the package was not sufficiently stimulative, it would not get the $1.5 billion kick for the $1 billion invested you would like to see. In fact, he predicted it would be well below one, and that is what has happened. We have got a tragedy of monumental proportions. Never has so much been spent for so little in the history of the world, in my opinion, and we are going to carry this $900 billion debt. At 4 percent interest, that is $36 billion a year in interest on that for as long as we live until I am in the grave. And if the interest goes up to 6 percent, which is the historic average—and I am sure we are headed there—you are talking about $54 billion a year. We just did not get enough out of it, and it was not a good idea.

Also, you know, they have accused Congress and now the President of having deficit attention disorder, but let me ask you all this question: The budget—representatives of Cabinet Secretaries have been before this Committee in the last 2 weeks. Education proposes to have in the President's budget an 11-percent increase; Energy, 9.5; State Department, 10.5; Transportation, a 62-percent increase; the lowest was Defense at a 5-percent increase.

Do you think in this time of financial stress that next year's budget should include, I will ask each of you, increases that far above the inflation rate—what is inflation, 2 percent?—five-plus times the inflation rate.

Senator Domenici, should we do better?

Hon. DOMENICI. Absolutely. It is too much, far too much. The point I am trying to make in my remarks, however, is if you are going to have a fight over each one of those, it would be far better if you had a fight with a plan that addressed all of them and everything rather than somebody picking at one program and saying, "I got it. I got $10 billion more than they did." You have to have some leadership saying, "We are not interested in that kind of fight."

Senator SESSIONS. You have been through those fights, and you have got experience, and so has the Chairman.

I think you are right, Mr. Chairman. We do need to develop a more comprehensive plan that considers all of this in total. I have to say that.

I guess, Dr. Rivlin, you would agree this year, hopefully—I think we will see a decline as the economy hopefully grows. But we hit 25 percent of GDP is Federal spending equals that. I will ask you two brief questions. Could we as a government use the money we spend more effectively to help create growth and jobs? And could we raise revenue that we are raising more effectively so that we enhance the ability of growth and jobs to be created?

Hon. RIVLIN. Yes and yes. We could certainly spend more effectively, and I have talked in my statement——

Senator SESSIONS. You did.

Hon. RIVLIN [continuing]. About the importance of doing that. And we could tax more effectively.

I do believe that we got something for the stimulus. Maybe not enough. One could read Gary Becker's remarks as saying we did not do it big enough. But we got the economy turned around and growing again, and that was not obvious 2 years ago that that would be achievable. It is not growing fast enough to create enough jobs.

I also agree with the President that we need to make room in the budget for investments in the future. One might not agree with all of the particular ones he proposed. I am not a huge enthusiast of doing high-speed rail right now. But the idea that we must prune back what we have been doing in order to make room for growth and for investments in future growth, particularly in the skills of the labor force, it seems to me is an important idea.

Hon. DOMENICI. Let me say on this, I agree but guardedly. I am not convinced that we will make room for these expenditures. I am fearful that we will add these things on top of other expenditures and say we need these and will not be cutting anything. I think you ought to cut the things that are not investments, if you want to use that word—and it is a very hard word to use because what is an investment to you is just a plain expenditure to the next guy. But you certainly have to make sure that you are making room for these innovative things that are for the future by cutting other things. That is the problem we always have. We cannot get the group that is supposed to do the cutting, we cannot get them to cut things. When you reduce, they just leave everything as is, and it all gets reduced a little bit, and we keep the same package of programs.

Senator SESSIONS. I agree. Government is not nearly as effective as private business in making those tough choices; we need to in-

vest more here, we need to cut here. We tend to keep what we have got and just spend more on the new program.

Senator Domenici, just practically, politically, you have been in this body far longer than I and any member of this Committee. The entitlement situation that we are confronting, Secretary Geithner and Director Lew basically said in our Committee that the President is not interested, he did not put any entitlement reform in his budget. Some of our members think it is sort of like riding down the entitlement trail through a New Mexico gulch, and the President is sitting there with a little ambush planned, and not only is not in favor of entitlement reform but actually would oppose reforms that happen.

Isn't that at least a legitimate concern that Republicans who do favor confronting entitlements have, unless we can do so in a bipartisan way, politically, just realpolitik?

Hon. DOMENICI. Well, Senator, I said in my remarks—and thinking back on it, I fumbled it a little bit, but let me just make it eminently clear. I think you have to proceed without the President because the problem is so critical.

But the way to solve the problem involves the need for a leader who is explaining the problem and leading the parade, leading those who are trying to get there. And there can only be one in the United States, and that is the President. And I said it, I am sorry to say, that he is not leading. Here you are having a meeting facing up to this issue, and you do not know that you will have a President backing what you suggest in a bipartisan—even if you do it bipartisan. So that is another tough one to add to this problem that is tough without that.

So that is my feeling, and I believe the problem is so big that you are going to have to try to solve it at the congressional level, bipartisan, and you are going to have to get mutuality of support without the President from each others as Democrats and Republicans in the House and in the Senate. It is the only way to do it. If the problem is as big as it is, you have to do it.

Senator SESSIONS. Thank you, Pete, and I think both of you share that. I see Senator Warner, he is working with Senator Chambliss on an effort to confront these issues. I salute him for that. Something could break there. The Chairman is willing to discuss these issues. But the situation is more problematic, I think, and I am not just trying to be political here. I am just saying as a reality the President did not mention it in his State of the Union, he did not mention it in his budget, and it definitely puts us in a more difficult position.

Dr. Rivlin, if you wanted to——

Hon. RIVLIN. Yes, I just wanted a minute for equal time here. I agree that the President has to get into this game and has to play a very important part in it. I think he does need bipartisan cover. If he got out front in the State of the Union or the budget, there was the risk that because he said it, the Republicans would be against it.

So I have great hope for the bipartisan effort in this body, led by Senators Warner and Chambliss and participated in by the Chairman and others who have been leaders of bipartisan efforts.

I believe that effort can give the President the bipartisan cover that he needs to jump into the pool, which he absolutely has to do.

Senator SESSIONS. Well, sometimes Presidents have to lead and should not always be seeking cover. But I think it is possible. I think we are in a situation where we could make something happen, and I hope so.

Chairman CONRAD. I would just note parenthetically that on the Fiscal Commission five of the six representatives of the President voted for the recommendations. Five of the six representatives of the Senate voted for the recommendations. Five of the six representatives of the House, including all the Republicans, voted against. So we have had one example on the Fiscal Commission of Democrats and Republicans, five Democrats, five Republicans, one Independent, going out and favoring a plan. And I think the President looks at that and he says, Gee——

Senator SESSIONS. Well, if he is coming, hope springs eternal.

Chairman CONRAD. Yes, we have got to do it. I agree with Senator Domenici. This is such a threat to the country. We have got to do it, and we have got to do it this year.

Senator Begich.

Senator BEGICH. Thank you very much, Mr. Chairman.

I have a few questions, but I guess I first want to ask Senator Domenici—and thank you very much for your years of service and all the work you have done.

Hon. DOMENICI. Thank you.

Senator BEGICH. Let me ask kind of a general question, kind of two fronts. One, you know, we are in the midst of this 2-week, 3-week continuing resolution.

Hon. DOMENICI. Yes.

Senator BEGICH. I call it kind of "Groundhog Day." Every couple weeks the same thing. Are we missing our opportunity—because I am going to use your comments here, and it says, "Contrary to recent rhetoric, policymakers cannot solve the debt crisis simply by eliminating congressional earmarks or foreign aid, which is part of the discretionary spending," so forth, so on. Are we missing an opportunity to broaden this discussion from just discretionary—because that is what we are stuck in right now. You know, all we are doing is slicing away at discretionary. But both of you in your testimony have said you have got to do a broader picture. Do you think we are missing an opportunity as we are sitting here right now in kind of a tug of war?

Hon. DOMENICI. Well, Senator, I guess you would know, if you served as long as I did, that you would have experienced this same—whatever you——

Senator BEGICH. Groundhog Day.

Hon. DOMENICI. We had more than one Groundhog Day during my time. We had to extend it 2 or 3 days just to—because there was a real issue pending, and you were trying to get it resolved. And when you got it resolved you were ready.

Senator BEGICH. Right, right.

Hon. DOMENICI. But that is not what is happening now, so it is a little different Groundhog Day because it is not being used because there is one problem to be solved and you need an extension. There is, you know, a tsunami of a difference between the two par-

ties on what we ought to do. I do not think you are missing anything because I do not think anybody—I do not think both parties want to get the same thing done. So I do not know what——

Senator BEGICH. We are too far apart.

Hon. DOMENICI. Too far apart. However, when it comes to the extension of the debt, that is an opportunity to debate. It is an opportunity to amend. It is an opportunity to offer a plan. I do not know if people will be ready then. Clearly, one would hope that the debt limit would be extended on the basis that it is an American debt. It is no longer a Democrat or Republican debt. It belongs to Americans. It has got to be solved by Americans. I wish I were here to make the point, but I cannot help you. That is the case. But that could be, if you had enough time for Warner and his six people, five people, they might put the plan on the debt limit. That has been used for historic things. A huge procedural reform called Gramm-Rudman-Hollings was passed on a debt limit bill.

Senator BEGICH. Right.

Hon. DOMENICI. It should not be, but that is the way it was done. It looks to me that the Senate has the bipartisan capacity to move ahead with a package. I do not see the same thing in the House. But this is a strange thing, if you started it in one and got it there, who knows what would happen if it got over to the other House? It might be well received there, too. That means, Senator Warner, that I am saying godspeed to your bipartisan efforts. And I know how tough they are. You are not missing an opportunity. There 5 an opportunity to think big there. But the opportunities fail are there, too.

Senator BEGICH. Let me, if I can, I have a few more—kind of a list of questions. In the appendix of your report, you list—and it was just kind of an illustration, but the concept was interesting. It was to increase fees charged by the Commodity Futures Trading Commission as one example to kind of pay for it. If you use it, you pay for it. Did you have a consistent kind of philosophical debate in the task force? Either of you could answer this. And in that question, I will only tell you, as a former mayor, that we did a lot of that where we said, look, if you are going to go for a zoning change, why should the general taxpayers pay for that, that benefits you personally or your business personally, you should pay for it if you want it.

Did you have a general conversation—and either one of you could answer this—in the broader sense of some of these types of things? You know, why should I, if I do not do any trading of commodities, pay for the fees that are charged by the Commission to regulate that industry? A comment on that?

Hon. RIVLIN. We did have a general conversation that there was potential for raising fees in the manner you suggest. We suggest a few other examples. One was the Pension Benefit Guaranty Corporation (PBGC), the agency that takes care of the private retirement plans that are in trouble, and a couple of others.

The problem is that, unlike cities, though, the Federal Government's budget is dominated by big spending programs, and you do not get very far with the fees. But you have got to go as far as you can.

Senator BEGICH. Let me, if I can, go to another comment, switch topics here for a second: the tax reform that you all laid out here, which I am a big believer in. You know, today is Corporate Tax Day. For those who do not know that, today is when corporations have to send in their tax forms. We had to do a couple in our family today and make sure they were done. The system is a nightmare. And I know Senator Wyden of this Committee as well as some others—and I have supported it—are trying to find a pathway. To reform to deal with the deficit and the debt, how important is dealing with this tax reform simultaneously to this effort? Is it as important or is it a secondary kind of if we get to it, we get to it? Senator or Doctor, whichever one.

Hon. DOMENICI. I will give you a quick answer, and Alice can give you a more detailed one. It was important enough that one of our chief spokesmen in favor of this program today was not for it throughout our deliberations until we got to tax reform, and he got to understand it as presented by two of the members who were tax experts and presented it. He called it the "sizzle." It was necessary for the package.

Senator BEGICH. Understood.

Hon. DOMENICI. And I think that is a good common word. In answer to your question, it is the sizzle that will carry the package in the minds of some people, especially the lowering of the income tax rates and to get rid of the so-called—not earmarks.

Senator BEGICH. Loopholes.

Hon. DOMENICI. Loopholes. I used the same word, "loopholes."

Senator BEGICH. Yes.

Hon. DOMENICI. So it is very important in our opinion to getting a package through that you get the tax one part of it.

Senator BEGICH. Do you want to add to that?

Hon. RIVLIN. I think it is essential that we reform the Tax Code because, as I said earlier, even if we try very, very hard to reform entitlements on the spending side, we are going to need more revenue, and we cannot raise it effectively and efficiently from this broken tax system. We need a better tax system.

Senator BEGICH. And lastly, just more of a request for you, and my time is up. But you had mentioned in your testimony—and I am one of these that believe that we have got to deal with the deficit, debt. Social Security is over here. That is a different issue. That is sustainability and making sure it lasts. There is a line, a dotted line not a solid line, but I think—so my question—you had mentioned—you had a proposal in here, but you also mentioned you had another idea or proposal—I might have misheard you—that does not deal with the age increase that you may have. I would be very interested in seeing that. Did I mishear that? I do not want to——

Hon. RIVLIN. Our proposal makes various long-term changes in Social Security, both on the revenue side and on the benefit side. The basic problem, as you know, has to do with people living longer and taking their benefits over a longer period.

Senator BEGICH. Right. My mother would say that is good news.

Hon. RIVLIN. That is good news, but it is more expensive.

Senator BEGICH. Right.

Hon. RIVLIN. So what do you do about it?

We looked at a couple of options. One is raising the retirement age, and Simpson-Bowles did do that far in the future.

Senator BEGICH. Right.

Hon. RIVLIN. We opted for a different approach which is equivalent. We opted for indexing the benefit to longevity, which means that over time people get less benefits, but over their longer period. And it is equivalent in the arithmetic, but what it does is say for people who have very heavy, difficult jobs, you do not have to keep working until 65 or 69 or whatever you raise it to. But if you do retire early, you will get less. So it would, we think, encourage people to work longer.

Senator BEGICH. Work longer.

Hon. RIVLIN. It is a different way of solving the same problem.

Senator BEGICH. Interesting. Thank you very much, Mr. Chairman.

Chairman CONRAD. Thank you, Senator.

Senator Johnson.

Senator JOHNSON. Thank you, Mr. Chairman.

Senator Domenici and Dr. Rivlin, I just got a promotion here. First of all, let me say I share your concern. The fact that this Nation is heading toward a fiscal train wreck, that is the only reason I stepped up to the plate and ran for the Senate. Otherwise, I would be perfectly content back in Oshkosh, Wisconsin, running a plastics plant.

I also share your disappointment in terms of lack of Presidential leadership here. I find it baffling. When you run for President, you run to lead the Nation, and the fact that we do not have that leadership is sorely disappointing.

I think the number one component to the solution here really is economic growth, and I want to first concentrate a little bit on that. I want to talk a little bit in terms of the current CR.

From my standpoint, one of the ways you get economic growth is to restore confidence. And the fact that we are still toying around with funding this fiscal year's budget is just amazing to me. The House has proposed a $61 billion cut to real spending. I believe that would be a real confidence boost, and I just kind of would like to get your comment on what is happening currently between the House and the Senate. And would you agree with me that if we just get a $61 billion cut passed, that would increase confidence and let us move on and start actually talking about the 2012 budget?

Hon. DOMENICI. Well, you are looking at me. You have not said who you are sending the question to, but I will answer.

Senator JOHNSON. Both, I would like.

Hon. DOMENICI. I think you could read between the lines of what I said in my testimony, and I believe confidence building is an important aspect of how we get out of the turmoil of the lack of economic growth. However, I regrettably do not think the $60 billion has much to do with the 10-year plan that I think we have to get done. Now, that is just my opinion. If you can get $60 billion out of it, it is $60 billion you do not have to get later. But in terms of confidence building, I think it is not a winner. It is just getting out of a mess. And I acknowledge that the way we are doing this is not very good government, not very good business. We ought to

surely be ashamed and get out of it and get on with some better way to solve the budget that is behind us.

People cannot understand. There is not a confidence building because they do not know what we are talking about. You see the news man talking about the $60 billion, people do not know that it is not next year's budget. We have not gotten to that yet. It is this year's budget. How do you get $60 billion out of this year's budget and call it confidence building? It is just kind of doing something you have to do. So I regret to tell you I do not agree. I wish I could.

Hon. RIVLIN. I do not agree either. I think $61 billion is too much to take out of a year that is half over, and that the real confidence builder would be to get on with it, compromise somehow. The solution has to be partisan. It has to be signed by the President. So compromise and get past it and get on to the real issues. The real confidence builder would be to solve the long-run problem, putting in place a multi-year plan that takes account of all of the parts of the budget that need to go to getting us back on a fiscally responsible track.

Senator JOHNSON. Okay. In terms of your solutions, in terms of getting economic growth, was a temporary payroll tax holiday. My concern with any kind of temporary tax decrease is—I think the history proves those are generally just saved, versus a long-term solution. I would just kind of like your comments on that.

Hon. DOMENICI. Well, let me say 2 months ago or 2 and ½, months ago or 3 months ago when we were discussing this, this seemed like the best thing we could possibly advocate. I only wish they would have done it 5 or 6 months ago, that is, the tax holiday for payroll tax. I think that probably of all the stimulus packages we have been thinking about, it probably would have gotten us out of the doldrums and we would be moving. It would add 1 or 2, maybe 2.5 percent, take that much out of the unemployment.

I am quite sure that this is such an extraordinary temporary tax that it would not continue on. We are suggesting that the only reason we can do it in our package is because we have a new tax to pay into the Social Security tax, or we could not do it. In other words, we are certain that we are not robbing the Social Security Trust Fund because in our new tax we take the money out. If you cannot do that, then you should not do this stimulus package because it should be paid for in the next 5 or 6 years with taxes that have been imposed to pay for it.

Hon. RIVLIN. We thought it was the easiest and clearest thing to do to get money into all working people's pockets quickly and make sure that the recovery was sustainable.

I do not think that a full payroll tax holiday is very much part of the conversation right now. The partial was put in the agreement that you all passed in December. And I believe it is helping, that people are getting a little more in their paycheck and they are spending a little more, and that is good.

Senator JOHNSON. Okay. A number of times in your——

Hon. DOMENICI. Sir, could I interrupt?

Senator JOHNSON. Sure.

Hon. DOMENICI. I do not mean to take time away from him, Mr. Chairman, with this comment. I really believe that what I am

doing is trying to build in you more and more each time I talk to you the idea that Democrats and Republicans have to decide that the next election is not as important as having an America for the next election. And so they would agree to join hands and solve an American debt problem and take it out from the partisanship of the day. If Senators and Congressmen could sign that kind of pledge, we would be on our way. If they really did not care enough about getting elected—if they did not care about getting re-elected and cared more about saving the country, we would have a shot at this. We think our package and the new tax that we added, you could ask the question, Isn't that just an easy tax to put in there forever and even be raised? I remind you we have not waived the filibuster rule. It is still hard to pass a new tax in the United States Senate, regardless of which one it is. And, therefore, we think our holiday and our new tax adopted with the entitlement reforms that are big would save the country, and actually with the tax reform, it would be more progressive than the Tax Code we have today, more progressive in terms of the rich and the poor and who is taxed and quadrennials and all that stuff. It would be better than what we have got today, this new one.

Senator JOHNSON. Mr. Chair, could I just ask one more question?

Chairman CONRAD. Sure.

Senator JOHNSON. Senator Domenici, you just hit on progressivity, and I wanted to ask that question. In 2008, according to the Tax Foundation, the top 1 percent paid 38 percent of the total income tax; the top 5 percent, almost 60 percent; the top 50 percent paid 97 percent of all income tax. Isn't one of our problems in terms of generating revenue—and, again, I like to generate revenue the old fashioned way—by growing the economy. Isn't one of our problems that we have actually narrowed the tax base? And I think one of the things you are trying to do with the national sales tax is actually broaden that. So I guess I am a little confused as to why a number of times during your report you are taking credit or, you know, enjoying the fact that you are increasing progressivity. I do not see that as a positive.

Hon. DOMENICI. Alice, do you want to do that?

Hon. RIVLIN. I do believe in a progressive income tax, but I agree that we need a broad-based consumption tax as well. That is why we put both in.

The way we reform the income tax is to broaden the base of the income tax and lower the rates.

Hon. DOMENICI. Right.

Hon. RIVLIN. Now, many liberals are allergic to that because it sounds like lowering the rates is going to let rich people off easily. But actually it does not, and that is the reason we emphasize this. When you get rid of many of the loopholes, the exclusions and deductions, those are taken advantage of mainly by upper-income people. So that the way we reform the Tax Code preserves the progressivity of the income tax in order to offset the regressivity of the consumption tax. And I think that is the right way to do it.

Hon. DOMENICI. Might I say, Senator, I told you when I shook your hand up there that I have listened to you of late and that I was very proud of what you had to say, and I think do not let the cumbersome nature of this job get you down. Just remember the

big picture. That is what you were elected for. And you have a good feel for what the big picture is, but the institution will keep you from using it. You have got to find ways to use it.

Excuse me for talking too much, but you cannot do anything to me at this point. [Laughter.]

Chairman CONRAD. Except bang the gavel.

Senator Whitehouse.

Senator WHITEHOUSE. Thank you, Chairman.

Senator Domenici, it is very nice to have you back.

Hon. DOMENICI. Thank you.

Senator WHITEHOUSE. I really enjoyed our time together. You and Senator Warner were particularly kind to a new Senator of the other party, and I have never forgotten it, and it was one of my best early memories of the Senate.

Dr. Rivlin, thank you also for being here.

I worry that we are missing something very important on health care, and I think when the accounting people get at it, they get blinders on and want to see the things that they can calculate. They want to see the things that OMB can score. And I think that builds in a sort of professional bias that causes people like you who are real leaders on this to understate an opportunity that we have out there. And I just want to plead with you to speak a little bit more about the health care problem as you go around.

Let me just tell you, believe it or not, I actually agree with Congressman Ryan, who said, "If you want to be honest with the fiscal problem and the debt, it really is a health care problem. If you look at the future of our debt, primarily it comes from our health care. We have to reform those if we are going to get this debt crisis under control."

And what I see is a health care system that is exploding in costs and that is driving both the private and public sectors. This is not a situation in which public health care cost is exploding but the private sector is doing a good job at keeping it under control. They are not. It is out of control because the underlying system is out of control. And there are an array of opportunities that are being pursued in different ways right now: a better electronic health record so that there is better information flow; improvement in quality so there are not so many medical errors and so there are not so many, you know, hospital-acquired infections and things like that that create enormous cost in the system; figuring out what prevention mechanisms actually save money so we can deploy them and get the savings; figuring out how to improve our payment system so that you are paying for results and not more procedures and doctors do not get to run up their billing score by prescribing more procedures; and, finally, getting rid of the colossal amount of waste and overhead that is run, particularly in the private insurance side.

You add all that up, and it is a really, really big difference. It has been estimated by the President's Council on Economic Advisers that it could be $700 billion a year. The New England Health Care Institute says it is $850 billion. Bush's Treasury Secretary O'Neill says it is $1 trillion. The Lewin Group agrees that it is $1 trillion. Whatever it is—we do not know—it is a really, really big number. The problem is because it is a process of discovery and

learning and invention and it is an iterative and dynamic process that will take us into that world, nobody can score it. I have had this discussion with the OMB folks. I have had this discussion with the CBO folks. They have sat where you have sat and they have said, yes, this is a really big number, this is a really big opportunity, but because of the nature of the beast we cannot score it. What we can score is when you change the inputs to the existing system. It is hard to score when you have to actually change the system. But our system, our health care system, is crying out for reform when at 18 percent of GDP we are getting worse results than the vast majority of our economic competitors, and they are spending at most 12 percent and less.

So I really urge you, even though it cannot be scored, even though you cannot plug a number in, when you are out there talking about this, please do not hesitate to talk about delivery system reform. You have an important platform, and this issue is being overlooked, and it is important. The numbers are too big, and this is too much of a national problem, not just a government spending problem, to get lost in this equation.

Hon. RIVLIN. I totally agree with you, and I think we are saying that, but maybe not loud enough. And I am glad you are saying it in the way that you are. I do think that the Affordable Care Act has potential for tapping into some of those savings, but also that we need to change the incentives in Medicare. Medicare can lead, and needs to, and one way to do that is to go to something like a premium support program. It is not the only way, but changing current Medicare is essential.

Hon. DOMENICI. Let me say, Senator, you said it all right, I think, and I would agree with everything you said. I would ask you, Is the fact that we are not scoring the kind of reform you allude to causing us to do less of that reform?

Senator WHITEHOUSE. Yes, I think the fact that it cannot be scored takes it off the equation, really, when the people who are not involved in health care but are involved in the budget discussion sit down because they want to be able to say if you do this, it saves X.

Hon. DOMENICI. Yes.

Senator WHITEHOUSE. And so something that if you do it—you do not know what it could save. It could save up to $1 trillion a year for America's health care system. But because you cannot put the number on it, you think, well, let us set that aside, we will talk about other things. And as a result, I think we are underinvesting, paying less attention. And that is a race that we are in, and we really need to get after it. So I appreciate that you both agree with me, and I thank you for letting me push on that.

Let me change to a slightly different topic. In 1935, for every dollar that an American individual contributed in revenues to our country, an American corporation also contributed a dollar. It was 1:1 back in 1935.

In 1948, it broke through to 2:1 so that the individual Americans were paying twice as much to support our Government as our corporations were.

In 1971, it broke through to 3:1, with three individual tax dollars for every corporate tax dollar—or revenue dollar, I should say.

In 1981, 4:1; and in 2009, it broke through to 6:1. American individuals put in $6 of revenue to support their country for every $1 of corporate revenue.

I guess my question is: That is a very significant shift of tax and revenue responsibility away from our corporate community and onto individual Americans. Is this inevitable as we hit a globally competitive environment? Or is there a way to make sure that our corporate community pays a share of this. The 6:1 is pretty unfair, it seems to me, considering the size and the role of corporations and the value that they get out of the American economy. But are we stuck with it?

Hon. DOMENICI. Well, I personally do not see it to be any significant negative about our system. That is just a question of how you chose to levy the tax.

One way to look at it is that you have got a lot more growth and money in the hands of individuals than you ever did before, and so they pay a bigger share. Likewise, American corporations no longer compete only here. They compete in the world, and you cannot stick to some ideas that are looking at an economy that must compete in a world, you cannot burden them with ideas that did not even consider that. Those things were not even in existence when they were put in.

So I think it is just an anomaly, not a fact that we should be worried about. Our companies are not able to do what companies have to do to grow and prosper now. I do not see—but for some exceptional corporations with some exceptional patents, nobody is making too much money. If anything, it is on the individual side that too much money is being made, not on the corporate side—or its richness.

Hon. RIVLIN. I think we are stuck with it because we have to compete in the world. But we could compete with a fairer, simpler corporate tax. The arguments for broadening the base of the corporate tax in order to bring the rate down are similar to that of the individual income tax and I think very persuasive.

Senator WHITEHOUSE. Thank you.

Thank you, Chairman.

Chairman CONRAD. Could I just wade in on two points that you made? Because I think in terms of the big idea that you are talking about on health care, you are exactly right. It is just inescapable that that is the 600-pound gorilla in the room. It is the health care accounts, not just Medicare but Medicaid. All of the health care accounts are jumping and they are jumping, CBO has told us, because health care expenditures are growing societally, and we are spending far more on a GDP basis, a share of the economy basis, than any other country. And, frankly, we are not getting significantly better health care outcomes than countries who are spending much less.

On the question of the tax burden, this is one thing that helped persuade me that we need to go to more of a hybrid system and have some consumption tax component because that is impossible for people to evade. They cannot go offshore. They cannot do these abusive tax shelters. If they consume, they pay.

Senator Warner.

Senator WARNER. Thank you, Mr. Chairman, and I want to thank Dr. Rivlin and Senator Domenici for their work and your kind comments, although I do need to make one correction. This is actually the Conrad effort on deficit reduction that Warner is just being a junior assister on.

But let me follow one of the things that Senator Whitehouse just said, and I think you raise a great issue. But I think just on the corporate rates the competition among States has been, you know, who can cut the most in terms of attraction of jobs. And I think we see kind of the—and I do not know where—I would tend to agree with Dr. Rivlin. We may be kind of stuck with it. But we are seeing the consequence of that kind of race with what is playing out in Europe right now, where Ireland built its economic attractiveness with one of the lowest corporate rates around, basically 10 to 12 percent. They attracted all this. They got overextended. They are now asking the EU to bail them out, and there is a great tension, as I am sure we have all followed, as the countries who are trying to bail out Ireland are saying you have got to raise your corporate rates back up. But huge, huge pushback, and I do think it raises the question of how can we find some other way, as the Chairman mentioned, to kind of get around the gaming of the system.

I would also argue, while I think we do need rate reduction at the corporate level and a flattening of those rates, I hear many of my colleagues in the corporate world complain about our 35-percent rate. Any major international company that is paying 35 percent ought to fire their CFO since their effective rates are much, much lower than that, and it is candidly small and mid-sized businesses and retail firms that are the only ones paying the full freight.

I have two quick questions I want to ask, and I appreciate—I know I am the last one up, and I again thank the Chairman for having this hearing.

One is that unlike Simpson-Bowles, you all, when you laid out your plan, actually had less cuts in discretionary spending than the Simpson-Bowles approach.

Hon. DOMENICI. Right.

Senator WARNER. And it is ironic now that the whole debate that is taking place up here in Congress is entirely focusing not on any of the other parts of the pie but focusing on that 12 percent of domestic discretionary spending. It just seems to me to be a zero sum game because while we can attack the effectiveness of certain Government programs, certain of these programs in domestic discretionary are actually where we get leverage, where we have State share contributions, where we are making investments to try to keep our country competitive. And I would just like you to both make a quick comment on why less of a meat axe to discretionary spending and more towards some of the more mandatory programs.

Hon. DOMENICI. Go ahead.

Hon. RIVLIN. We took what we thought was a quite aggressive stance on discretionary spending, namely, a hard freeze of 4 or 5 years, and that gets you a lot. We did not think doing more than that was sensible in the face of a fragile recovery. So we did not do as deep a cut in discretionary spending. But I think the tenor of this whole discussion is absolutely right. Let us get off discre-

tionary spending and get on to the things that really matter if we are going to avoid this debt crisis, and that is entitlements and taxes.

Hon. DOMENICI. Senator, I think I answered the question heretofore, but if I did not, I will repeat it. I do not believe the issue of saving the Republic from the debt—I do not believe that the discretionary cuts being proposed have much to do with that. As a matter of fact, we have less in the appropriated reductions than the President's Commission did, and if they chose to take more out of that, I would say that—understand that ours was truly bipartisan. That is the best we could get from—if you wanted all of them to do it, we had—they were not running for office. They were bipartisan Americans, and they had to vote for this. And so we are giving you what push and strain of that kind of group yields, and it does not give so much in this area because you do not—you run into a lot of programs that cause you more problems than they do good. And you can get to where you have to go without those, especially if you take on the entitlements, as we did.

Senator WARNER. One other thing that I wish—again, with the benefit of not being on either commission, your commission or the one that Senator Conrad served on, I wish both efforts, with 20/20 hindsight, when they announced their findings had broken their findings and did it under 2 days instead of a single day so that you could have one day on deficit reduction and one day on Social Security, because my understanding of your goals—and I know Simpson-Bowles was actually to make sure there was 75-year solvency with Social Security. And I think there has been some confusion that the two were mixed together. Again, that is just with Monday morning quarterbacking. I think we need to continue to make the case, and I think both your approach and what Simpson-Bowles did actually in terms of having that 75-year solvency were very progressive goals in terms of protecting that bottom quintile, plussing up folks, plus 80, trying to raise the cap, potentially doing, you know, some—I know you chose a different approach in terms of longevity, but you have got to address the fact of longevity. And some of this, again, is just math. Senator Whitehouse pointed out the differential on corporate rates, but as we all know, in 1960, 16 workers per one retiree, now it is down to 3.

I will close with this comment, since Senator Conrad and I—and I know Senator Wyden has also been part of efforts around tax reform and deficit reduction. Senator Domenici, this is more directed towards you since you in your career had two times that you were involved in this—once with a Republican President back in 1990, once with a Democratic President back in 1997. Do you have any advice for us in the trenches right now on how we get this done?

Hon. DOMENICI. Oh, my. Well, no, I do not, not specifically. But I tell you, you have to have very good people helping you. Your staff has to be the very best caliber in this area. You have to be searching for new ideas on how you put this together because that is really the clue. If you took midway between the President's group and ours and said let us cut it in half, except on the entitlements, let us do everything we said, and on the others let us split and let us do it, we still would not know how to adopt it. Right? You could sit down and have that, but what mechanism are we

going to use around here that has a chance of getting through? That is what you have to spend your time on.

Rudman was done not by me, but by Rudman and Gramm.

They put the details together. It took them a long time, and my staff tells me it is a very tedious thing. It is full of details. They had a bunch of smart people putting it together. It seems like we are knocking at that door right now and saying how do we open the door to something like that for your group.

We said in our joint testimony, because her testimony is mine and mine is hers, that we think you ought to use the budget resolution. You answered, Mr. Chairman—and it answers this question—by saying the budget resolution did not do the job. I do not know if it does or not, but I would submit that you ought to start—and I answer you—by taking a budget resolution and reconciliation instructions and look at the maximum that we have used them and see if you can find a way to build it into a budget resolution or even a second budget resolution later in the year—we have done two in a year—and have it all implementation of a budget plan and maybe get permission in the first one to get the second one done. Some such thing.

But, look, the most important thing is that you keep your optimism and your willingness to do this strong because this is hard work. I mean, you have done corporate work. I have done this work. And I do not take my hat off and say you did harder work in the private sector than I did. I do not believe that. I worked as hard as any human could on difficult matters for a cheap rate. I was cheap compared to what you guys in the private sector made. But I agreed to that, so I am not complaining. I said okay. So did Nancy.

He knows her. With eight kids, that was not a great decision. I was kind of a dummy. But, anyway, that is all I can do on yours.

Senator WARNER. Well, thank you.

Hon. DOMENICI. Get something from me that I am really with you.

Senator WARNER. Well, I appreciate it. And, you know, I managed to eke out a living in cell phones, which ended up being okay.

Hon. DOMENICI. That is all right.

Senator WARNER. I would just simply say we appreciate both your work, but we need your voices continuing to urge us, and I want to again thank the Chairman. He has been fighting this issue for a long, long time, and Senator Wyden has been fighting this issue for a long time on the tax reform side, and we are going to stay at it.

Chairman CONRAD. We thank the Senator for his leadership. He has been a terrific ally in trying to advance a more sustainable fiscal outlook for the country.

I would say on the question of budget resolution, as imperfect as it is—and it is imperfect, I know the Senator would acknowledge, because we do not control the policy.

Hon. DOMENICI. That is true.

Chairman CONRAD. It is very hard to convince people to put more revenue in if it is not going to lower rates, I would say. We do not control that. The second problem is the President is no part of the budget resolution because it never goes to the President.

But as imperfect as all that is, it may be our only shot.

Hon. DOMENICI. Might be.

Chairman CONRAD. There are other negotiations underway that Senator Warner is deeply involved in, as am I. Those may bear fruit. But it may be the case that our best shot is through the budget resolution, as imperfect as it is.

Senator Wyden.

Senator WYDEN. Thank you, Mr. Chairman. I want to thank you and Senator Warner. You all are doing a lot of heavy lifting, and it is very appropriate that we have Dr. Rivlin and Senator Domenici, two who continue to give this country extraordinarily valuable service and two that I call on frequently, so I thank you both.

I want to start with you, Dr. Rivlin, with respect to reinventing Medicaid. You and I have talked about it, you know, before. Social Security and Medicare get most of the discussion with respect to the entitlements, but I have long felt that it is urgently important to reinvent Medicaid.

And I have thought that the lodestar should be to say poor people ought to have choices like Members of Congress. That is essentially what I did in my legislation, the Healthy Americans Act, with 15 United States Senators. I said I want poor people to be able to choose from a menu of private plans and that they ought to be able to have access to the same kinds of doctors that Members of Congress have. I would really like to see us have the day in this country where the poor family sits next to a Congressperson's kid because to some extent Medicaid, if you look at its history, has been kind of apartheid. I mean, it has been a second tier kind of system. And I very much want to change that, and I am going to keep at that throughout my time in public service while I have the honor to represent Oregon in the United States Senate.

Now, we have one opportunity to start that right now, and I want to get your thoughts on it because I think it is very much consistent with your thinking.

The President last week endorsed the proposal that Senator Scott Brown and I have to speed up the chance for States to get waivers. And in the process, he pointed out that through a waiver a State could make it possible by way of starting to reinvent Medicaid, a State could make it possible for the poor in that State to start going to the exchanges and choosing from a menu of private policies. The reason I like this is I have always said that the marketplace changes on day one once people can start firing an insurance company for giving lousy service.

So my thought is, just on this part of the Medicaid debate, wouldn't it be very constructive as part of reinventing Medicaid—just as part; not everything that needs to be done—to start speeding up these opportunities for the poor now on Medicaid to start going to the exchanges, where you would also have a significant number of healthy people, as we hope down the road—it is not going to be the case at the beginning, but down the road be a group of healthy people, larger pools so that the poor could have more bargaining power, more leverage in a marketplace in the private sector, and could get more value for the dollar. Wouldn't that be a constructive step?

Hon. RIVLIN. I agree with the basic objective. I believe in the exchanges in the Affordable Care Act. We need to get them up and running. We do not have them yet except in Massachusetts, so it is a work in progress. And then ultimately we ought to transition Medicaid onto the exchanges. Maybe that can be done by waiver, I am not sure of all the details, but the objective I share.

Senator WYDEN. Well, thank you. And the President has already announced that that would be possible. And, in fact, under what he approved a week ago, it would be possible for a State with a one-stop application, one stop, to get a waiver to design its own affordable care proposal and be able to get what are, of course, known as the 1115 Medicare waivers. So we are going to call on you. I know you have got a real interest in reinventing Medicaid, and I am anxious to work with you. And to me, this is a doable step, one we can start on now, and it is very much consistent with where we ought to end up, which I do not think we ought to rest until poor people in this country have choices with respect to providers and systems much like Members of Congress have. And you have done a lot of work in this area.

Let me ask Senator Domenici a question about tax reform because you and I have talked about this, and as you know, Senator Gregg and I spent the better part of 2 years, week after week after week coming up with a reform proposal. I continue to talk with colleagues about it now. But Erskine Bowles and Alan Simpson made a point last week when they were here about an issue that I want to get your sense on it because you have been our leader on this Committee since really I got on it when I came to the Senate. And Erskine Bowles said that, with respect to the deficit, you cannot just cut your way out of it, you cannot just tax your way out of it; you also have to grow. You have got to grow substantially. And one of the things that attracted Senator Gregg and I to the tax reform issue is in the 2 years after the 1986 reform bill was passed, where Ronald Reagan and the Democrats got together, we created 6.3 million non-farm jobs. That is an amazing job production record, 6.3 million non-farm jobs.

I want to get your thought with respect to tax reform, and do you share this kind of principle of Alan Simpson and Erskine Bowles that the third leg of this stool—you know, cutting, we have got to generate some savings; and, you know, obviously people are going to be talking about other issues. But the third leg of the stool has got to be to grow and that growing both from the standpoint of creating jobs to put people to work and generating revenue has got to be part of the equation.

Hon. DOMENICI. No doubt about it. Our big statement that we introduced and my statement that I read from to you both say unequivocally that we have to broaden the base and get growth. We have to have a growth-oriented tax structure. As much as we can will it and see it, we ought to do it. And it also acknowledges the other principle that we cannot grow our way out of it singularly, that just growth will solve the problem. But what we say is we need growth to mesh with the other things that are going to happen so that we have jobs and prosperity.

So we not only want to do that—we not only believe that, but we want to do that. Our proposal says let us simplify it, make it easi-

er. Let us broaden the base. Let us get rid of the loopholes, which are not very efficient. Let people make more of the decisions, and make the corporate tax more accommodating toward growth. And then when we were short of revenue at the end, instead of choosing something in the income tax side that would be non growth, we chose a VAT-type sales tax added to the end of it.

When you put it together, it turns out to be very growth oriented, and at the same time, it turns out to be as progressive, if not more progressive, than what we have got today, provided you take care of the working poor in the manner we do in our Tax Code and the children in households that are poor.

Senator WYDEN. I am going to not get into the VAT issue this morning because, as you know, we had on the McCain vote, a big vote in the Senate against it. And I think the point really is you have put on the table both with respect to a balanced program and, particularly just that last answer, you became in my view another influential voice for saying that the principles of 1986, where we said we are going to get rid of a lot of these preferences, to hold down rates and keep progressivity, are as sound today as they were in 1986. Of course there are going to be debates. Chairman Conrad has noted that he was interested in various approaches in the Deficit Commission, and we had a vote on the McCain proposal here in the Senate. But if the anchor of tax reform—and that is what Judd Gregg and I agreed on—was going to be updating those principles of 1986—we have had 15,000 additions to the Tax Code. It comes to something like more than one for every working day in the last 25 years. According to one analysis I had, I mean, just think about what people are going through now. It is the middle of March. How about if we give the American people their springtime back and go with a simplified Tax Code, as you are recommending, which, by the way—you can never mention an intangible. I think people would feel much more confident if they could actually get on top of being able to fill out a tax return, which could have some benefits for the economy as well.

So I am going to call on your two often, and I just so appreciate the fact—and Senator Domenici touched on it in terms of, you know, public service—that you will put in all these long hours to get to folks in the Congress and for people in this country thoughtful recommendations that can help drive this debate. I thank you both.

Hon. DOMENICI. Thank you very much, Senator.

Chairman CONRAD. I just want to thank Senator Wyden as well. No individual has done more on health care reform and tax reform than has Senator Wyden. Two of the most far reaching proposals have come from him, and people that he partnered with on the Republican side, on tax reform with Senator Gregg, who used to be the Ranking Member here, my very close and dear friend, and is really the model that the two of you laid out that became the model for Simpson Bowles. We will not hang you with the result because the result is somewhat different than you propose, but it was really the work of the two of you that formed the basis for what Simpson-Bowles concluded, and you should be commended for it.

I want to thank the witnesses. We appreciate very much the contribution you have made here, the contribution you have made to

the country over many, many years. Senator Domenici, 34 years on this Committee, 22 years as the Chairman or Ranking Member, that I do not believe will be challenged by anybody in history. And, Director Rivlin, to be head of OMB, head of CBO, the deputy head of the Federal Reserve, that is a remarkable record of public service. We deeply appreciate it, and we appreciate the contribution you have made to the work of this Committee.

Hon. RIVLIN. Thank you, Mr. Chairman.

Hon. DOMENICI. Thank you, Mr. Chairman.

Chairman CONRAD. The Committee will stand adjourned.

[Whereupon, at 12:05 p.m., the Committee was adjourned.]

MODERNIZING PERFORMANCE: USING THE NEW FRAMEWORK

WEDNESDAY, MARCH 16, 2011

COMMITTEE ON THE BUDGET AND THE
TASK FORCE ON GOVERNMENT PERFORMANCE,
U.S. SENATE,
Washington, DC.

The Committee met, pursuant to notice, at 10:00 a.m., in Room SD–608, Dirksen Senate Office Building, Hon. Mark R. Warner, Chairman of the Task Force, and Hon. Kent Conrad, Chairman of the Committee, presiding.

Present: Senators Warner, Conrad, Stabenow, Whitehouse, Thune and Johnson.

Staff Present: John Righter, Amy Edwards, Mary Naylor, Marcus Peacock, and Gregory McNeill.

OPENING STATEMENT OF CHAIRMAN WARNER

Chairman WARNER. Good morning, and let me welcome you all to a hearing on the Budget Committee's Task Force on Government Performance. I am going to try to zip through my opening comments because, as I have told Gene, unfortunately we have scheduled two votes at 10:30, so we may have to adjourn for a few minutes and then come back for our second panel.

This is the first hearing in the 112th Congress of the bipartisan Task Force on Government Performance. I would like to start by thanking Chairman Conrad for lending me the gavel for this session and for his support of the Task Force. I would also like to thank Ranking Member Sessions and Senators Whitehouse, Cardin, Crapo, and Thune for their service as members of the Task Force. And I know that we have joined this morning as well by Senator Stabenow, and we do appreciate her interest in some of our work.

We are going to be focusing on two things today: the recent Government Accountability Office (GAO) study that Gene is going to be talking about in a few moments, and also the Government Performance Results Modernization Act, a new law that significantly updates the statutory framework for Government planning and performance reporting. I would like to call this—I hope history will show that it is the biggest little law that nobody has heard of in terms of its effect on a going-forward basis, and I really want again to thank Senator Stabenow for being here.

This law, the quick overview, really puts forward a new approach to the critical challenges we face in the country in terms of how we make sure that we get the most bang for the buck from our Gov-

ernment. And since we are holding this hearing in the Budget Committee hearing room and in the proud tradition of Senator Conrad and Senator Stabenow, let no meeting get started without a few charts and graphs. I thought it would be appropriate just for those of you who are not here on a regular basis to see why the challenge of getting the most effectiveness from our tax dollars is so eminently important at this moment.

So in the great tradition of Senator Conrad, the chart that we have always seen, regardless of subject matter, if we cannot get our act together, we are looking at deficits as far as the eye can see. And those of us who have been involved and grappling with this issue realize that, you know, $1-trillion-a-year-plus deficits are not sustainable; $14 trillion in debt is not sustainable. The fact that every day that we fail to act on this issue that we add literally $4 billion a day, Senator Stabenow, to our debt—$4 billion a day that at some point we are going to have to pay back—means that we have to leave no stone unturned.

So in light of the growing fiscal challenges—and that was our current status. Revenue is at kind of an all-time low; outlays at a total all-time high. Back in my old job as Governor, we would call this a structural budget deficit. The lines will never meet under our current approach, and that again is a requirement of why we must act.

This is the challenge of this Task Force, and let me be clear that trying to figure out how we save resources, how we avoid duplication, is a part. It is not going to make those lines meet in and of itself. It is not a single silver bullet. This is going to take enormous action on a series of fronts. But it is part of the challenge ahead of us.

So in light of the growing fiscal challenges, the Task Force's work is to identify strategies to save taxpayer dollars while also preserving important policy priorities. This is very important. Our area is not so much looking at solely elimination. It is looking at how we can maintain the key delivery of services but perhaps through consolidation and combination of services, something, again, that Senator Stabenow is looking at within her Agriculture Committee.

Government duplication and reorganization is a hot topic these days. The President has talked about it. GAO has talked about it. And, you know, we are definitely working in Congress to try and see if we can find some new solutions.

Senator Johnson, this is not such a hot subject matter that you have to as a new member sit down at the kids' table. Come on up here. [Laughter.]

Chairman WARNER. I recall from my first 2 years sitting literally in some of the rooms where they had to add an extra table. Fortunately, from the Democratic side we have already done some consolidation, and that kids' table has disappeared. We get to be at the big dais. But as a former business guy like myself, we welcome Senator Johnson. This should be a topic that I know he will have great interest in as well.

The President recently appointed my good friend Jeff Zients as the first Government Chief Performance Officer ever in an administration, and he has been recently tasked with the effort that the

President outlined in his State of the Union to start reorganization of the Federal Government. That is something that is enormously challenging, and that will bring us to our first witness in a few moments, but now we are going to go ahead and go through these very quickly, and that is something that Gene Dodaro is going to report in some detail, a recent, very important report of the GAO that talked about the amount of duplication that we see in the Federal Government. This is something that we have all been familiar with. I know Senator Stabenow has been familiar with it. I as a Governor always looked at workforce training, but, again, a few examples: 82 programs across 10 Federal agencies that focus on teacher quality; 56 programs across 20 agencies around financial literacy; 80 programs across 8 agencies that support transportation for disadvantaged persons. These are all important policy goals. We ought to be able to do it with less initiatives in a more consolidated effort. So that is what we are hopefully going to hear about today.

We also want to talk, particularly as we get to the second panel, about the Government Performance and Results Act (GPRA) bill, and this is actions that we took, Senators Carper and Akaka, on the Government Performance and Results Modernization Act. Again, I hope it will be the biggest little bill that no one has ever heard of in terms of real effect as we deal with deficit reduction.

Again, this legislation looked at a number of goals that have to be higher on our agenda. One of the things I think I have already seen in my short tenure here, and I know Senator Stabenow has talked about, and as a former business guy, Senator Johnson is concerned about as well, when we give agencies literally dozens and dozens of goals, they do not know what is important. So until we can focus agencies down to a manageable number, three to five goals, where we can then focus our resources in a better way, we are never going to get there.

We as well need, as we look at this kind of duplication and overlap, we need to make sure that we get out of our silos and within a policy area, even if it comes under different agencies, identify clear agency cross-cutting government-wide goals.

Right now our reporting is on an annual basis. I cannot think of a business that either one of us would run that would only allow annual reporting if we had our shareholders and stockholders, which are the taxpayers of America, not wanting to hear on a more regular basis so that we as, in effect, the board can act more quickly.

Within that, we have got to make sure that we identify programs that actually support the goals, and then we have to align this process with the congressional budget timetable.

Let us go ahead and go to the next set of goals, and this is something that actually—this is the new stuff. This is the stuff that actually I think will have enormous effect.

As we go into the deficits as far as the eye can see, as we have to make dramatic cutbacks on spending, one of the areas—and this is something that, quite frankly, even some in the administration resisted, which is to say let us actually ask agencies to identify those programs that are not working as effectively. Rather than simply having this initiative reside at OMB, why not ask the folks who are actually running programs to identify their top-performing

programs and their least performing programs? This will become a very important tool, again, as we work with GAO and we work with other efforts to see how we can improve performance.

As well, then, everything has got to be about accountability. We have got to hold our senior-level Government officials accountable, and we actually through this legislation create, in effect, a Chief Operating Officer and Chief Performance Officer within each agency so that there is not this kind of "That is not my responsibility." Management and accountability has not been always key priorities. We now have a person that will be identified. This will not be requiring new hires. It will be simply taking a member of the senior management team and making sure that this type of reporting, this type of identification, this type of operating oversight will fall within somebody's specific purview so that, again, we can hold them accountable.

This will allow us as Congress, I believe, to hold our agencies more accountable, and so that we are not simply adding new requirements—I mean, one of the things I recall as a Governor is, you know, you ask more from your workforce, particularly during tough times. But you cannot simply be additive all the time. We have got to actually remove some responsibilities so that we can really focus on what is important. And we have at least started by what I think should be the lowest hanging fruit. We are asking each agency to find areas where we can eliminate, my hope is, up to 10 percent of initial reporting requirements.

And then going to the next slide very quickly, this is where we found somebody saying actually something good about this bill, and you can read it on your own.

Now let us go ahead—and I want to thank staff who prepared a much more in-depth opening statement that thanked many more people than I have thanked so far this morning. Consider yourselves all thanked, and I thank the staff.

Now let us get to the panel because as I indicated at the outset, we have got two votes at 10:30, and I think you are going to find both the first panel and the second panel very interesting.

It is my pleasure to introduce our first witness on our first panel: Gene Dodaro, the Comptroller General of the United States at the Government Accountability Office. We are fortunate to have Mr. Dodaro with us today to share his recommendations on implementation of the new performance framework, but to also share his views about how to address the overlap and duplication from his recent report. I think many of us have seen and heard about the GAO's recent report that outlined with much greater specificity, I think it was over 280 different programs where we have duplication and overlap within the Federal Government.

As Comptroller General, Mr. Dodaro oversees the development of hundreds of reports each year that have led to billions of dollars in taxpayer savings and improvements to a wide range of Government programs and services. He has had a long career at the GAO of over 30 years, holding key executive posts such as Chief Operating Officer and heading the largest division in accounting and information management, as we all know, the valuable contributions that GAO makes here every day in Congress and, in fact, a GAO fellow, Ben Licht, supported the development of the performance

legislation that we discuss today and putting to work many of the recommendations that the GAO has made over the years. And I want to thank Ben again for his good work on the Performance Task Force last year. It made me happy to have him re-detailed to us again if it would be to your choosing.

So please join me in welcoming Mr. Dodaro. The floor is now yours.

STATEMENT OF THE HONORABLE GENE L. DODARO, COMPTROLLER GENERAL OF THE UNITED STATES, U.S. GOVERNMENT ACCOUNTABILITY OFFICE

Hon. DODARO. Thank you very much, Mr. Chairman. Good morning to you, Senator Stabenow, Senator Johnson. I am pleased to be here today to discuss opportunities presented through implementation of the Government Performance and Results Modernization Act to address issues both identified in our overlap, duplication, and fragmentation report, but also in the biannual report we issue listing for Congress high-risk areas that are high risk due to fraud, waste, abuse, and mismanagement, or in need of broad-based transformation.

There are five aspects of the Government Performance and Results Modernization Act that I think are extremely important, and I would like to highlight those today.

The first deals with adopting a more coordinated and centralized approach on cross-cutting issues across Government to achieve meaningful results. This area of emphasis is extremely important because more and more problems require the combined efforts and talents and expertise of multiple Federal agencies to significantly address the problem. And it is also important to deal with the overlap, duplication, and fragmentation that we mention in our report.

Senator Warner, you highlighted three areas in our report on financial literacy and the teacher quality area and transportation for disadvantaged people. But there are other areas in there—employment and training programs, and surface transportation programs. We identified many areas, and these are areas where programs have accumulated over time, some over decades. And as a result, there is a real need to rationalize these programs to set clear priorities. As you mentioned, what is the Federal role? What are we trying to achieve? Greater clarity is needed in all these areas that we have identified in the overlap and duplication report, and the implementation of this act could be helpful in that regard, although there are some opportunities to act quickly. I would be happy to talk about those in the Q&A session.

Secondly, the focus of the GPRA Modernization Act on the management functions of Government, it highlights five for attention: human resource, financial management, IT, acquisition, and procurement among those. This is very important. Many of these areas or aspects of these areas are on our high-risk list, and achieving better results in Government requires making additional strides in improving this management infrastructure and attention to detail. And I am hopeful that as OMB implements the requirements in each of these functional areas, they also look at the need to have an integrated approach to these management functions.

Over time, just like the Government Performance and Results Act, there has been legislation focused on financial management, information technology, human resources, and it has had some salutary benefits and improvements, but we are a long way from having the management infrastructure needed to successfully tackle these problems and effectively implement the GPRA Modernization Act. And there is a need for integration. Human resources obviously is important to having the right people in the acquisition workforce, IT, and financial management. IT and financial management need to be integrated effectively. So I am hopeful that there will be plans put forward not only to improve each functional area on its own but to have an integrated approach.

The third area is the emphasis on having better performance information. This is critical and absolutely essential to better inform decision-making. Senator Warner, as you point out, in our report on overlap and duplication there are a number of areas that we were not able to come up with precise estimates, because the costs of these programs are not really clear, either in implementation or administrative cost, but also performance information is lacking, particularly in the employment and training area and in the economic development area. We do not really know what the outcomes of these programs are producing and whether they are achieving meaningful results. The same thing is true in food assistance. Eleven of the 18 programs we looked at, we could not tell what the effectiveness of those programs was because there was not empirical data in that regard.

The last two areas I would mention together, and that is, dedicated, sustained leadership—you mentioned the quarterly reviews; this is absolutely imperative—and also engaging Congress in an ongoing dialogue. I hope Congress is not only reactive to outreach from the administration but proactive in providing its views to the administration to help implement these areas.

I would close by saying the two areas we were able to take off the high-risk list this year were able to be taken off because senior leadership in the administration focused on them. There were good metrics to be used. They followed a sustained process, and Congress held over a dozen congressional hearings on each of the two high-risk areas. Those are the ingredients for success along with having good data and having a proper focus on the priorities.

I want to assure this Committee that GAO will continue to remain focused on helping promote effective implementation of the GPRA Modernization Act because it is absolutely essential, and we look forward to working with the Congress and the administration to make sure the act achieves its potential for reduced costs and better performance for the American citizens.

So thank you very much for inviting me today, and I would be happy to answer any questions.

[The prepared statement of Hon. Dodaro follows:]

United States Government Accountability Office

GAO

Testimony
Before the Committee on the Budget,
U.S. Senate

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GOVERNMENT PERFORMANCE

GPRA Modernization Act Provides Opportunities to Help Address Fiscal, Performance, and Management Challenges

Statement of Gene L. Dodaro
Comptroller General of the United States

GAO-11-466T

March 16, 2011

GAO Highlights

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Highlights of GAO-11-466T, a report to the Committee on the Budget, U.S. Senate

GOVERNMENT PERFORMANCE

GPRA Modernization Act Provides Opportunities to Help Address Fiscal, Performance, and Management Challenges

Why GAO Did This Study

The federal government is the world's largest and most complex entity, with about $3.5 trillion in outlays in fiscal year 2010 that fund a broad array of programs and operations. GAO's long-term simulations of the federal budget show—absent policy change—growing deficits accumulating to an unsustainable increase in debt. While the spending side is driven by rising health care costs and demographics, other areas should also be scrutinized. In addition, there are significant performance and management challenges that the federal government needs to confront.

GAO was asked to testify on how the provisions of the Government Performance and Results Act (GPRA) Modernization Act of 2010 (GPRAMA) could, if effectively implemented, help address these challenges. Our statement is based on our past and ongoing work on GPRA implementation, as well as our recently issued reports (1) identifying opportunities to reduce potential duplication in government programs, save tax dollars, and enhance revenue; and (2) updating our list of government operations at high risk due to their greater vulnerabilities to fraud, waste, abuse, and mismanagement, or the need for broad-based transformation. As required by GPRAMA, GAO will periodically evaluate implementation of the act and report to Congress on its findings and recommendations.

View GAO-11-466T or key components. For more information, contact Bernice Steinhardt at (202) 512-6543 or steinhardtb@gao.gov.

What GAO Found

GAO's past and ongoing work illustrates how GPRAMA could help address government challenges in five areas:

Adopting a more coordinated and crosscutting approach to achieving meaningful results. GPRAMA could help inform reexamination or restructuring efforts and lead to more efficient and economical service delivery in overlapping program areas by identifying the various agencies and federal activities—including spending programs, regulations, and tax expenditures—that contribute to crosscutting outcomes. These program areas could include multiple employment and training programs or numerous teacher quality initiatives, among others.

Addressing weaknesses in major management functions. Agencies need more effective management capabilities to better implement their programs and policies. GPRAMA requires long-term goals to improve management functions in five key areas: financial, human capital, information technology, procurement and acquisition, and real property. GAO's work has highlighted opportunities for improvements in each of these areas and aspects of several of them are on the GAO high-risk list.

Ensuring performance information is both useful and used in decision making. Agencies need to consider the differing needs of various stakeholders, including Congress, to ensure that performance information will be both useful and used. For performance information to be useful, it must be complete, accurate, valid, timely, and easy to use. Yet decision makers often do not have the quality performance information they need to improve results. To help address this need, GPRAMA requires (1) disclosure of information about accuracy and validity, (2) data on crosscutting areas, and (3) quarterly reporting on priority goals on a publicly available Web site.

Instilling sustained leadership commitment and accountability for achieving results. Perhaps the single most important element of successful management improvement initiatives is the demonstrated commitment of top leaders, as shown by their personal involvement in reform efforts. GPRAMA assigns responsibilities to a Chief Operating Officer and Performance Improvement Officer in each agency to improve agency management and performance.

Engaging Congress in identifying management and performance issues to address. In order for performance improvement initiatives to be useful to Congress for its decision making, garnering congressional buy-in on what to measure and how to present this information is critical. GAO has previously noted the importance of considering Congress a partner in shaping agency goals at the outset. GPRAMA significantly enhances requirements for agencies to consult with Congress.

Mr. Chairman, Ranking Member Sessions, and Members of the Committee:

Thank you for the opportunity to discuss how the provisions put into place by the Government Performance and Results Act (GPRA) Modernization Act of 2010 (GPRAMA),[1] could help address significant fiscal, performance, and management challenges facing the federal government. The federal government is the world's largest and most complex entity, with about $3.5 trillion in outlays in fiscal year 2010 that fund a broad array of programs and operations. Looking forward, our long-term simulations underscore the need to begin addressing the long-term federal fiscal outlook. Absent changes in fiscal policy, the structural imbalance between spending and revenue paths lead to large and growing deficits. The accumulation of large deficits leads to an unsustainable increase in debt over the long term.[2] This, in turn, will limit budget flexibility and the federal government's ability to respond to future challenges.

Addressing these fiscal challenges will require action on several fronts. First, all federal programs and activities—discretionary programs, mandatory spending, revenues, and tax expenditures—need to be reexamined. Second, program structures that are outmoded, overlapping, duplicative, fragmented, and not up to the challenges of the times must be reformed or restructured. In this regard, we recently issued a report that identified over 80 areas of potential duplication, overlap, or fragmentation as well as cost savings and revenue-enhancing opportunities.[3] In addition, weaknesses in management capacity, both governmentwide and in individual agencies, undermine efficient and effective government. Here too, our recent update to our high-risk list identified numerous opportunities to reduce costs and improve government performance.[4]

[1]Pub. L. No. 111-352, 124 Stat. 3866 (2011). GPRAMA amends the Government Performance and Results Act of 1993, Pub. L. No. 103-62, 107 Stat. 285 (1993).

[2]GAO, *The Federal Government's Long-Term Fiscal Outlook: Fall 2010 Update*, GAO-11-261SP (Washington, D.C.: Nov. 15, 2010). GAO updates these simulations twice each year. Updates and additional information on the federal fiscal outlook, federal debt, and the outlook for state and local government sector is available at: http://www.gao.gov/special.pubs/longterm.

[3]GAO, *Opportunities to Reduce Potential Duplication in Government Programs, Save Tax Dollars, and Enhance Revenue*, GAO-11-318SP (Washington, D.C.: Mar. 1, 2011). An interactive, Web-based version of the report is available at: http://www.gao.gov/ereport/gao-11-318SP.

[4]GAO, *High-Risk Series: An Update*, GAO-11-278 (Washington, D.C.: February 2011). Additional information available on GAO's High-Risk and Other Major Government Challenges Web site, http://www.gao.gov/highrisk.

Moving forward, the GPRA Modernization Act can offer opportunities to help make tough choices in setting priorities as well as reforming programs and management practices to better link resources to results.

My statement today, which is based on our past and ongoing work, will focus on five key areas where the requirements of GPRAMA could help address government challenges. In particular, the act calls for:

- a more coordinated and crosscutting approach to achieving meaningful results,
- efforts to address weaknesses in major management functions,
- ensuring performance information is both useful and used in decision making,
- sustained leadership commitment and accountability for achieving results, and
- engaging Congress in identifying management and performance issues to address.

Finally, my statement will speak to GAO's role in evaluating implementation of this act.

Adopting a More Coordinated and Crosscutting Approach to Achieving Meaningful Results

The federal government faces a series of challenges that in many instances are not possible for any single agency to address alone. Many federal program efforts, including those related to ensuring food safety, providing homeland security, monitoring incidence of infectious diseases, or improving response to natural disasters, transcend more than one agency. Agencies face a range of challenges and barriers when they attempt to work collaboratively. GPRAMA establishes a new framework aimed at taking a more crosscutting and integrated approach to focusing on results and improving government performance. It requires the Office of Management and Budget (OMB), in coordination with agencies, to develop—every 4 years—long-term, outcome-oriented goals for a limited number of crosscutting policy areas. On an annual basis, OMB is to provide information on how these long-term crosscutting goals will be achieved.

This approach will provide a much needed basis for more fully integrating a wide array of federal activities as well as a cohesive perspective on the long-term goals of the federal government that is focused on priority policy areas. It could also be a valuable tool for governmentwide reexamination of existing programs and proposals for new programs.

Our recent report on duplication, overlap, and fragmentation highlights a number of areas where a more crosscutting approach is needed—both across agencies and within a specific agency. Effective GPRAMA implementation could help inform reexamination or restructuring efforts related to these and other areas by identifying the various agencies and federal activities—including spending programs, regulations, and tax expenditures—that contribute to each crosscutting goal. Examples from our work include:

- *Employment and training programs*: In fiscal year 2009, 47 federal employment and training programs spent about $18 billion to provide services, such as job search and job counseling, to program participants. Most of these programs are administered by the Departments of Labor, Education, and Health and Human Services (HHS). We found that 44 of the 47 programs overlap with at least one other program in that they provide at least one similar service to a similar population. Our review of 3 programs among the largest—Temporary Assistance for Needy Families (TANF), Employment Service, and Workforce Investment Act (WIA) Adult programs—found that they provide some of the same services to the same population through separate administrative structures. Although the extent to which individuals receive the same services from these programs is unknown due to limited data, these programs maintain parallel administrative structures to provide some of the same services such as job search assistance to low-income individuals.

  At the state level, the TANF program (which also provides a wide range of other services) is typically administered by the state human services or welfare agency, while the Employment Service and WIA Adult programs are typically administered by the state workforce agency and provided through one-stop centers. Agency officials acknowledged that greater efficiencies could be achieved in delivering services through these programs but said factors such as the number of clients that any one-stop center can serve and one-stop centers' proximity to clients, particularly in rural areas, could warrant having multiple entities provide the same services. Colocating services and consolidating administrative structures may increase efficiencies and reduce costs, but implementation can be challenging.

  Some states have colocated TANF employment and training services in one-stop centers where Employment Service and WIA Adult services are provided. Three states—Florida, Texas, and Utah—have gone a step further by consolidating the agencies that administer these programs, and state officials said this reduced costs and improved services, but they

could not provide a dollar figure for cost savings. States and localities may face challenges to colocating services, such as limited office space. In addition, consolidating administrative structures may be time consuming and any cost savings may not be immediately realized.

To facilitate further progress by states and localities in increasing administrative efficiencies in employment and training programs, we recommended in 2011 that the Secretaries of Labor and HHS work together to develop and disseminate information that could inform such efforts. As part of this effort, Labor and HHS should examine the incentives for states and localities to undertake such initiatives, and, as warranted, identify options for increasing such incentives. Labor and HHS agreed they should develop and disseminate this information. HHS noted that it lacks legal authority to mandate increased TANF-WIA coordination or create incentives for such efforts. Sustained oversight by Congress could help ensure progress is realized.

- *Military health system:* The responsibilities and authorities for the Department of Defense's (DOD) military health system are distributed among several organizations within DOD with no central command authority or single entity accountable for minimizing costs and achieving efficiencies. Under the military health system's current command structure, the Office of the Assistant Secretary of Defense for Health Affairs, the Army, the Navy, and the Air Force each has its own headquarters and associated support functions. Annual military health system costs have more than doubled from $19 billion in fiscal year 2001 to $49 billion in 2010 and are expected to increase to over $62 billion by 2015.

  DOD has made varying levels of progress in implementing limited actions to consolidate certain common administrative, management, and clinical functions. However, to reduce duplication in its command structure and eliminate redundant processes that add to growing defense health care costs, DOD could take action to further assess alternatives for restructuring the governance structure of the military health system. A May 2006 report by the Center for Naval Analyses showed that if DOD and the services had chosen to implement one of the three larger-scale alternative concepts studied by DOD, the department could have achieved significant savings. Our adjustment of those projected savings into 2010 dollars indicates those savings could range from $281 million to $460 million annually depending on the alternative chosen and numbers of military, civilian, and contractor positions eliminated. DOD officials said that they generally agreed with the facts and findings in our analysis.

- *Teacher quality programs:* In fiscal year 2009, the federal government spent over $4 billion specifically to improve the quality of our nation's 3 million teachers through numerous programs across the government. We identified 82 distinct programs designed to help improve teacher quality, either as a primary purpose or as an allowable activity, administered across 10 federal agencies. The proliferation of programs has resulted in fragmentation that can frustrate agency efforts to administer programs in a comprehensive manner, limit the ability to determine which programs are most cost effective, and ultimately increase program costs.

  In 2009, we recommended that the Secretary of Education work with other agencies as appropriate to develop a coordinated approach for routinely and systematically sharing information that can assist federal programs, states, and local providers in achieving efficient service delivery. The Department of Education has established working groups to help develop more effective collaboration across Education offices, and has reached out to other agencies to develop a framework for sharing information on some teacher quality activities, but it has noted that coordination efforts do not always prove useful and cannot fully eliminate barriers to program alignment, such as programs with differing definitions for similar populations of grantees, which create an impediment to coordination.

  Congress could help eliminate some barriers through legislation, particularly through the pending reauthorization of the Elementary and Secondary Education Act of 1965 and other key education bills. Specifically, to minimize any wasteful fragmentation and overlap among teacher quality programs, Congress may choose either to eliminate programs that are too small to evaluate cost effectively or to combine programs serving similar target groups into a larger program. Education has already proposed combining 38 programs into 11 programs in its reauthorization proposal, which could allow the agency to dedicate a higher portion of its administrative resources to monitoring programs for results and providing technical assistance.

- *Domestic ethanol production:* Congress supported domestic ethanol production through a $5.4 billion tax credit program in 2010 and through a renewable fuel standard that applies to transportation fuels used in the United States. The ethanol tax credit and the renewable fuel standard can be duplicative in stimulating domestic production and use of ethanol, and can result in substantial loss of revenue to the Treasury. The ethanol tax credit was recently extended at 45 cents per gallon through December 31, 2011. The tax credit will cost $5.7 billion in forgone revenues in 2011. Because the fuel standard allows increasing annual amounts of

conventional biofuels through 2015, which ensures a market for a conventional corn starch ethanol industry that is already mature, Congress may wish to consider whether revisions to the ethanol tax credit are needed, such as reducing, modifying, or phasing out the tax credit.

Addressing Weaknesses in Major Management Functions

Although agencies have made progress improving their operations in recent years, they need more effective management capabilities to better implement new programs and policies. As part of the new governmentwide framework created by GPRAMA, OMB is required to develop long-term goals to improve management functions across the government. The act specifies that these goals should include five areas: financial management, human capital management, information technology management, procurement and acquisition management, and real property management.[5] All five of these areas have been identified by GAO as key management challenges across the government.[6] Moreover, some aspects of these areas have warranted our designation as high risk, either governmentwide or at certain agencies—such as strategic human capital management and real property management across the federal government and financial management at DOD.

In addition, a number of the cost-savings or revenue-enhancement opportunities we recently identified touch on needed improvements to management functions.[7] Examples include:

- *Noncompetitive contracts:* Federal agencies generally are required to award contracts competitively, but a substantial amount of federal money is being obligated on noncompetitive contracts annually. Federal agencies obligated approximately $170 billion on noncompetitive contracts in fiscal year 2009 alone. While there has been some fluctuation over the years, the percentage of obligations under noncompetitive contracts recently has been in the range of 31 percent to over 35 percent.

  Although some agency decisions to forego competition may be justified, we found that when federal agencies decide to open their contracts to competition, they frequently realize savings. For example, the Department

[5]31 U.S.C. § 1120(a)(1)(B).

[6]More information on our work related to challenges in these five management functions is available at http://www.gao.gov/highrisk/challenges/.

[7]GAO-11-318SP

of State (State) awarded a noncompetitive contract for installation and maintenance of technical security equipment at U.S. embassies in 2003. In response to our recommendation, State subsequently competed this requirement, and in 2007 it awarded contracts to four small businesses for a total savings of over $218 million. In another case, we found in 2006 that the Army had awarded noncompetitive contracts for security guards, but later spent 25 percent less for the same services when the contracts were competed.

In July 2009, OMB called for agencies to reduce obligations under new contract actions that are awarded using high-risk contracting authorities by 10 percent in fiscal year 2010. These high-risk contracts include those that are awarded noncompetitively and those that are structured as competitive but for which only one offer is received. While sufficient data are not yet available to determine whether OMB's goal was met, we are currently reviewing the agencies' savings plans to identify steps taken toward that goal, and will continue to monitor the progress agencies make toward achieving this and any subsequent goals set by OMB.

- *Undisbursed grant balances:* Past audits of federal agencies by GAO and Inspectors General, as well as agencies' annual performance reports, have suggested grant management challenges, including failure to conduct grant closeouts and undisbursed balances, are a long-standing problem. In August 2008, we reported that during calendar year 2006, about $1 billion in undisbursed funding remained in expired grant accounts in HHS's Payment Management System—the largest civilian grant payment system, which multiple agencies use. In August 2008, we recommended that OMB instruct all executive departments and independent agencies to track undisbursed balances in expired grant accounts and report on the resolution of this funding in their annual performance plan and Performance and Accountability Reports. As of January 13, 2011, OMB had not issued governmentwide guidance regarding undisbursed balances in expired grant accounts.

- *Unneeded real property:* Many federal agencies hold real property they do not need, including property that is excess or underutilized. Excess and underutilized properties present significant potential risks to federal agencies because they are costly to maintain. For example, in fiscal year 2009, agencies reported underutilized buildings accounted for over $1.6 billion in annual operating costs. In a June 2010 Presidential Memorandum to federal agencies, the administration established a new target of saving $3 billion through disposals and other methods by the end of fiscal year 2012; the President reiterated this goal in his 2012 budget. However, federal agencies continue to face obstacles to disposing of unneeded

property, such as requirements to offer the property to other federal agencies, then to state and local governments and certain nonprofits at no cost. If these entities cannot use the property, agencies may also need to comply with costly historic preservation or environmental cleanup requirements before disposing of the property. Finally, community stakeholders may oppose agencies' plans for property disposal.

OMB could assist agencies in meeting their property disposal target by implementing our April 2007 recommendation of developing an action plan to address key problems associated with disposing of unneeded real property, including reducing the effect of competing stakeholder interests on real property decisions. The President's fiscal year 2012 budget proposed the Civilian Property Realignment Act (CPRA) for congressional consideration. The act would establish a Civilian Property Realignment Board modeled on the Base Closure and Realignment Commission. We are engaged in discussions with Congress to determine how we can best support Congress, should the act become law.

Ensuring Performance Information Is Both Useful and Used in Decision Making

Agencies need to consider the differing information needs of various users—such as agency top leadership and line managers, OMB, and Congress—to ensure that performance information will be both useful and used in decision making. We have previously reported that to be useful, performance information must meet diverse users' needs for completeness, accuracy, validity, timeliness, and ease of use. GPRAMA puts into place several requirements that could address these needs.

- *Completeness:* Our work on overlap and duplication has found crosscutting areas, such as surface transportation programs or domestic food assistance programs, where performance information is limited or does not exist. In shedding light on these areas, the new crosscutting planning and reporting requirements could lead to the development of performance information in areas that are currently incomplete.
- *Accuracy and validity:* Agencies are required to disclose more information about the accuracy and validity of their performance information in their performance plans and reports, including the sources for their data and actions to address limitations to the data.
- *Timeliness and ease of use:* While agencies will continue to report annually on progress towards the rest of their goals, GPRAMA requires reporting for governmentwide and agency priority goals on a quarterly basis. By also requiring information to be posted on a governmentwide Web site, the act will make performance information more accessible and

easy to use by stakeholders and the public, thus fostering transparency and civic engagement.

In addition, to help ensure that performance information is used—not simply collected and reported as a compliance exercise—GPRAMA requires top leadership and program officials to be involved in quarterly reviews of priority goals. During these sessions, they are expected to review the progress achieved toward goals; assess the contributions of underlying federal organizations, programs, and activities; categorize goals by their risk of not being achieved; and develop strategies to improve performance.

To be successful, these officials must have the knowledge and experience necessary to use and trust the information they are gathering. Building analytical capacity to use performance information and to ensure its quality—both in terms of staff trained to do the analysis and availability of research and evaluation resources—is critical to using performance information in a meaningful fashion and will play a large role in the success of government performance improvements. Federal officials must understand how the performance information they gather can be used to provide insight into the factors that impede or contribute to program successes; assess the effect of the program; or help explain the linkages between program inputs, activities, outputs, and outcomes. To that end, within 1 year of enactment, GPRAMA requires the Office of Personnel Management (OPM), in consultation with the Performance Improvement Council, to identify the key skills and competencies needed by federal employees to carry out a variety of performance management activities including developing goals, evaluating programs, and analyzing and using performance information. Once those key skills and competencies are identified, OPM is then required to incorporate those skills and competencies into relevant position classifications and agency training no later than 2 years after enactment.

Instilling Sustained Leadership Commitment and Accountability for Achieving Results

Perhaps the single most important element of successful management improvement initiatives is the demonstrated commitment of top leaders. This commitment is most prominently shown through the personal involvement of top leaders in developing and directing reform efforts. Organizations that successfully address their long-standing management weaknesses do not "staff out" responsibility for leading change. Top leadership involvement and clear lines of accountability for making management improvements are critical to overcoming organizations' natural resistance to change, marshalling the resources needed in many

cases to improve management, and building and maintaining the organizationwide commitment to new ways of doing business.

GPRAMA creates several new leadership structures and responsibilities aimed at sustaining attention on improvement efforts at both the agency and governmentwide levels. The act designates the deputy head of each agency as Chief Operating Officer (COO), with overall responsibilities for improving the management and performance of the agency. In addition, the act requires each agency to designate a senior executive as Performance Improvement Officer (PIO) to support the COO. The act also establishes a Performance Improvement Council—chaired by the OMB Deputy Director for Management and composed of PIOs from various agencies—to assist the Director of OMB in carrying out the governmentwide planning and reporting requirements.

GPRAMA also creates individual and organizational accountability provisions that have the potential to keep attention focused on achieving results. For each governmentwide performance goal, a lead government official is to be designated and held responsible for coordinating efforts to achieve the goal. Similarly, at the agency level, for each performance goal, an agency official, known as a goal leader, will be responsible for achieving the goal. To promote overall organizational accountability, the act requires OMB to report each year on unmet agency goals. Where a goal has been unmet for 3 years, OMB can identify the program for termination or restructuring, among other actions.

Engaging Congress in Identifying Management and Performance Issues to Address

In order for performance improvement initiatives to be useful to Congress for its decision making, garnering congressional buy-in on what to measure and how to present this information is critical. In past reviews, we have noted the importance of considering Congress a partner in shaping agency goals at the outset. Congressional committee staff, in discussing the Program Assessment Review Tool (PART)[8] developed by the previous administration, told us that communicating the PART assessment results was not a replacement for the benefit of early consultation between Congress and OMB about what they consider to be

[8]OMB described PART, which was created in 2002, as a diagnostic tool meant to provide a consistent approach to evaluating federal programs as part of the executive budget formulation process.

the most important performance issues and program areas warranting review.[9]

While GPRA called for agencies to consult with Congress on their strategic plans, the act did not provide detailed or specific requirements on the consultation process or how agencies were to treat the information they obtained. GPRAMA significantly enhances requirements for agencies to consult with Congress when establishing or adjusting governmentwide and agency goals. OMB and agencies are to consult with relevant committees, obtaining majority and minority views, about proposed goals at least once every 2 years. In addition, OMB and agencies are to describe on the governmentwide Web site or in their strategic plans, respectively, how they incorporated congressional input into their goals.

Beyond this opportunity to provide input to OMB and agencies as they shape their plans, Congress can also play a decisive role in fostering results-oriented cultures in the federal government by using information on agency goals and results as it carries out its legislative responsibilities. For example, authorizing, appropriations, and oversight committees could schedule hearings to determine if agency programs have clear performance goals, measures, and data with which to track progress and whether the programs are achieving their goals. Where goals and objectives are unclear or not results-oriented, Congress could articulate the program outcomes it expects agencies to achieve. This would provide important guidance to agencies that could then be incorporated in agency strategic and annual performance plans. Most important, congressional use of agency goals and measured results in its decision making will send an unmistakable message to agencies that Congress considers agency performance a priority. Congressional oversight and sustained attention by top administration officials are essential to ensuring further improvement in the performance of federal programs and operations. In fact, as we noted in our recent high-risk issues report, these two factors were absolutely critical to making the progress necessary for the DOD Personnel Security Clearance Program and the 2010 Census to be removed from our high-risk list.[10]

[9]GAO, *Performance Budgeting: PART Focuses Attention on Program Performance, but More Can Be Done to Engage Congress*, GAO-06-28 (Washington, D.C.: Oct. 28, 2005).

[10]GAO-11-278.

GAO's Role in Evaluating GPRAMA, High Risks, and Other Major Government Challenges

Realizing the promise of GPRAMA for improving government performance and accountability and reducing waste will require sustained oversight of implementation. GAO played a major role in evaluating the implementation of the original GPRA's strategic and annual performance planning requirements, including various pilot provisions. For example, by evaluating agency plans during a pilot phase, we were able to offer numerous recommendations for improvement that led to more effective final plans.[11] We further supported implementation by reporting on leading management practices that agencies should employ as they implemented GPRA.[12]

Similarly, GPRAMA includes provisions requiring GAO to review implementation of the act at several critical junctures, and provide recommendations for improvements to implementation of the act. First, following a period of interim implementation, by June 2013, GAO is to report on implementation of the act's planning and reporting requirements—at both the governmentwide and agency levels. Subsequently, following full implementation, by September 2015 and 2017, GAO is to evaluate whether performance management is being used by federal agencies to improve the efficiency and effectiveness of agency programs. Also in September 2015 and 2017—and every 4 years thereafter—GAO is to evaluate the implementation of the federal government priority goals and performance plans, and related reporting required by the act.

Looking ahead, a number of other required recurrent reports will help to inform Congress about government management and performance. For example, GAO has an ongoing statutory requirement to report each year on federal programs, agencies, offices, and initiatives, either within departments or governmentwide, which have duplicative goals or activities.[13] In addition, each year GAO reports on its audit of the consolidated financial statements of the U.S. government[14] and the

[11]See for example, GAO, *Managing for Results: Critical Issues for Improving Federal Agencies' Strategic Plans*, GAO/GGD-97-180 (Washington, D.C.: Sept. 16, 1997) and *Managing for Results: An Agenda to Improve the Usefulness of Agencies' Annual Performance Plans*, GAO/GGD/AIMD-98-228 (Washington, D.C.: Sept. 8, 1998).

[12]See for example, GAO, *Executive Guide: Effectively Implementing the Government Performance and Results Act*, GAO/GGD-96-118 (Washington, D.C.: June 1996).

[13]Pub. L. No. 111-139, § 21, 124 Stat. 8, 29 (2010), 31 U.S.C. § 712 note.

[14]31 U.S.C. § 331(e)(2).

condition of federal financial management systems.[15] GAO continues to report periodically to Congress on the adequacy and effectiveness of agencies' information security policies and practices and other requirements of the Federal Information Security Management Act of 2002.[16]

Additionally, the Presidential Transition Act of 2000[17] identifies GAO as a source of briefings and other materials to help inform presidential appointees of the major management issues, risks, and challenges they will face. During the last presidential transition, we identified for Congress and the new administration urgent issues and key program and management challenges in the major departments and across government. Finally, GAO reports to each new Congress on government operations that it identifies as high risk due to their greater vulnerabilities to fraud, waste, abuse, and mismanagement, or the need for broad-based transformation to address economy, efficiency, or effectiveness challenges.

In conclusion, everything must be on the table as we address the federal long-term fiscal challenge. While the long-term outlook is driven on the spending side of the budget by rising health care costs and demographics, other areas of the budget should not be exempt from scrutiny. All areas should be reexamined in light of the contributions they make to achieving outcomes for the American public. If programs are overlapping, fragmented, or duplicative, they must be streamlined. Programs and management functions at significant risk of waste, fraud, and abuse must be corrected. GPRAMA provides the administration and Congress with new tools to identify strategies that are achieving results as well as those that are ineffective, duplicative, or wasteful that could be eliminated. GAO stands ready to help Congress ensure that the act's promises are met.

Thank you, Mr. Chairman, Ranking Member Sessions, and Members of the Committee. This concludes my prepared statement. I would be pleased to answer any questions you may have.

[15]31 U.S.C. § 3512 note.

[16]E-Government Act of 2002, Pub. L. No. 107-347, Title III, 116 Stat. 2899, 2946 (2002).

[17]Pub. L. No. 106-293, §2(3), 114 Stat. 1035 (2000).

Contacts

For further information on this testimony, please contact Bernice Steinhardt, Director, Strategic Issues, at (202) 512-6543 or steinhardtb@gao.gov. Key contributions to this testimony were made by Elizabeth Curda (Assistant Director), and Benjamin T. Licht. Contact points for our Congressional Relations and Public Affairs offices may be found on the last page of this statement.

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Chairman WARNER. Well, thank you, Mr. Dodaro, and I appreciate your testimony.

And I have to acknowledge, Senator Johnson, that I committed a faux pas, which I was just reminded of here. Maybe you did not realize as also a relatively new member. I was supposed to go to you to see if you had opening comments at the outset before I went to the witness. But in an effort to try to make sure that—since this is a new Task Force, I have got a whole series of questions, but I will go ahead and let you go first, Senator Johnson, and then I will make sure that since we have got Senator Stabenow here that she gets—we all get a bite at the apple before the votes start. So I will defer my questions for a few moments.

Senator JOHNSON. Well, thank you. Is it "Mr. Chairman"? Is that how I—I am really new at this, plus I did not realize I was at the kids' table there. [Laughter.]

I thought the kids' table would be something separate.

Mr. Dodaro, thanks for coming here today. I come at this as a new member, but also as somebody who has operated for the last 31 years a manufacturing business. I would call it a small to medium-sized business. And my experience in that business is anytime I would compete against a larger company, it was extremely easy to compete with a large company because of the bureaucracy. A smaller company is far more lean, far more efficient, far more effective. And I guess that is kind of how I come at Government as well.

So I would just kind of like your comments as you are kind of going through some of the solutions. My concern would be additional layers of management. I have already had the opportunity to talk to some other folks in agencies, and what they are describing is what I see in larger corporations, too: high levels of bureaucracy and so many different layers of management that they simply are unable to function.

So I would just kind of like to get your comments on—you know, we are facing a $1.65 trillion-a-year budget this year. We are going to have to have cuts. Frequently in business, the way you get more efficient and more effective is by coming in and cutting budgets. So I just want to get your comments on leaning down, downsizing agencies and having that be part of the solution in terms of getting people effective and efficient.

Hon. DODARO. My views on management issues are number one, accountability is not always fixed in individuals. I think this legislation, the modernization legislation, and some other initiatives recently by the administration on improper payments is you have fixed accountability with the political leadership of our Government and the way it is set up.

Now, there are opportunities to streamline the management functions and the bureaucracies in the agencies, but my concern has been, as I have seen this and been a student of Government over several decades, that turnover among the political leadership in the administration is a main limitation on sustained efforts of the Federal Government to make improvements. The average tenure of political appointees in the executive branch is still about 2 years. So there is constant turnover. There needs to be sustained attention over a period of time to be able to do this. So I think the

quarterly reviews in the GPRA Modernization Act are an important tool to move forward on this area.

There are always opportunities to streamline organizational structures, but it has got to start with a clear purpose of what the Federal Government wants to achieve. In a lot of these areas, it is not really that clear where you have dozens of programs trying to do similar things across multiple agencies. So there needs to be leadership. There need to be accountability. And I bet in your manufacturing operation you had much better cost data and performance data to make informed decisions than what is currently available in the Federal Government right now. That needs to be fixed as well. You can streamline all the management you want, but if you do not have good information, whoever is left is not going to be able to make good decisions.

Senator JOHNSON. That really leads to two points. To what extent are Government agencies audited? What percent of agencies actually go through an annual audit?

Hon. DODARO. Yes. Right now all Federal departments and agencies are required to have annual financial audits, but I would make a couple points here.

Number one, the first requirements for Federal agencies to prepare financial statements and have financial audits started in 1996, so our government operated for many, many years without the discipline of a financial audit, and that has improved over time. Of the 24 largest departments and agencies, 20 were able to get a clean audit, an unqualified audit opinion, this year but with some notable big exceptions: one, the Department of Defense and, second, the Department of Homeland Security.

So my main point is that the Federal Government was the last sector of our economy to require audited financial statements with the publicly traded companies coming during the Depression. Even the Federal Government required State and local governments to have financial audits in order to receive Federal assistance in the 1970s. But it is a relatively new development at the Federal level, and it is something where greater progress needs to be made.

For 14 straight years, we have not been able to give an opinion on the consolidated financial statements of the Federal Government due to limitations at DOD and problems at Treasury in reconciling transactions among the Federal Government. Financial management needs to be a top priority of this Congress and this administration to continue to make progress.

Senator JOHNSON. Let me just ask one more question. How pervasive and how effective are mission statements within these agencies really to find what the mission of a particular agency or a subagency is within those?

Hon. DODARO. Well, we have not systematically looked at that. We have evaluated strategic plans. And I will go back. I will provide something for the record there rather than overgeneralize at this particular point. But what I would say that in our recent report on overlap and duplication and fragmentation, it is not always clear for the individual programs what they are supposed to achieve. And I think this is an issue that both the administration and the Congress need to focus on when programs are created and reauthorized. It is not always as clear as it needs to be.

Senator JOHNSON. Thanks.

Chairman WARNER. Let me just quickly add a couple of points before I turn to Senator Stabenow. You know, one of the purpose of the GPRA bill was these agencies keep getting loaded up with different priorities, oftentimes from Congress, and so if you have got 50 priorities, you have no priorities. So part of the goal of this legislation is to hone that down to three to five goals so you have got a real mission statement, to look across duplicative programs and try to have these similar goals identified across these different programs that may be even in different agencies even if they have got the same goal. If they have got the same goal, you can look then in terms of how you consolidate, point number one.

Point number two, there is going to be a chance on the kind of middle management tier or even senior management tier with the kind of wave of retirements we are going to have from the baby-boom generation. We really ought to think how and maybe put some pause on replacing some of those folks as we think about efforts to consolidate. It is a lot easier to do that with this wave of attrition coming than dramatic reorganizations. And one of the questions—I am going to begin to move to Senator Stabenow and Senator Whitehouse and reserve my time for later—is with your study on duplication how we could at least, as we initiate new programs, make sure that Congress is aware with some kind of red flag before we initiate something new. You know, it might be the greatest new food safety program around or some member has got a great idea, but we ought to know whether there are 13 other programs doing exactly the same goal before we start something new. I do not think we have that kind of in the normal process at this point.

Senator Stabenow.

Senator STABENOW. Well, thank you very much, Mr. Chairman, and first I want to thank you for spending the time and the focus and the leadership to bring us both not only to this legislation but where we can go in terms of the implementation of this, because I think this is extremely significant in the long run for the Federal Government. We are at a time, obviously because of the deficits, where it becomes particularly concerning. But regardless of that, it really is a moment in time to do a reset, I think, on the Federal Government in terms of looking at where we are in terms of technology, global economy, where we are going overall on being more effective and efficient. And so I want to thank you for that.

I have to say, though, when thinking about our capacity as we have a board of directors of 435 people in the United States House of Representatives and 100 Members in the United States Senate and a White House, it is a little different challenge than the private sector. Having been both in the public and the private sector, it is certainly a different challenge on the private sector side with a long-term CEO and a board setting the agenda as opposed to our great democracy and all of our strengths. But one of the challenges is, of course, bringing everybody together on the same number of goals and following through long term, which I think is a challenge.

My questions come more with my hat on now coming into this session as the new Chair of the Agriculture, Nutrition, and Forestry Committee, where we are going to be writing a farm bill. I

have challenged and encouraged not only members but the agricultural community broadly, the United States Department of Agriculture (USDA) broadly, to think in terms of principles not programs. What do we want to achieve rather than just program by program? And how can we do that more effectively and efficiently given the challenge around dollars?

And I would also, just as a caveat to my colleagues, say that the USDA and agriculture has already contributed $4 billion last year in savings to the deficit, so when we are talking about cutting, we are already contributing to that.

But when we look overall at something which is actually more manageable, our Committee works extremely well together. It is not about partisanship. It is about what commodities you grow in your State, and so we will develop a farm bill, and we will work together.

But when we look at how we evaluate effectiveness of programs and—for instance, one of our questions is actual farm-based risk, what is most effective helping production agriculture be able to have the tools they need to manage risk, to be to have a farm safety net and so on. When we get into that level, what would you suggest to us as we evaluate? I mean, we can start with goals, and we will. We will be talking, Senator Roberts and I working together very closely to focus on what do we want to achieve. And we can look at duplication in a broad sense in terms of numbers of programs.

Hon. DODARO. Right.

Senator STABENOW. But what would you then suggest as we go to the next step in terms of effectiveness of programs?

Hon. DODARO. I would look at the clarity of the measures and why the programs were initially created. And whether or not some of the programs in the agriculture area that initially started out as temporary programs have become a permanent program. We point out one, the direct farm payments, in our overlap, duplication, and fragmentation report. The program was initially supposed to be terminated in 2002. It is still being continued. There are few people who are receiving the assistance.

And so I think looking at the original purposes of the legislation—and this is true in places across the Government other than agriculture——

Senator STABENOW. Sure.

Hon. DODARO [continuing]. Where programs are put in, well intended, intended to be temporary programs. Then they take on a life of their own, and they are continued over time. So that would be one area I would suggest you focus on originally, is which of those programs were intended to be temporary and give priority to reviewing those programs first.

Also, we have found in looking at some of the support programs, particularly in crop insurance, that a lot of the administrative costs have been high and excessive, and we have made recommendations, some of which Congress has acted on and others are still open. We would be happy to provide your Committee with support on all of our findings in the agriculture area which are not reflected in our current report.

Senator STABENOW. Thank you. I would like very much to follow up with you, and I know the Committee would as well.

Thank you, Mr. Chairman.

Chairman WARNER. Senator Thune.

Senator THUNE. Thank you Mr. Chairman, and thank you for being here.

I want to thank the Chairman and the Ranking Member for holding this hearing today because I think it is an important one to have. We have all suffered through and we have heard from our constituents of the various troubles that unfortunately our overly bureaucratic Government creates for people who have to do business with it.

The GPRA Modernization Act is designed to inform us of weak performance in these programs. It will help give us a picture of what needs to be reformed, what needs smart investment, and what needs to be completely cut. However, without any congressional attention, this information will be useless.

So I propose the creation of a joint committee on deficit reduction which will be tasked with processing information like this and proposing cuts equal to 10 percent of the previous year's deficit.

Now, cutting spending, obviously, is not going to solve all of our problems, but it is unacceptable that we would waste any money when we have got 40 cents out of every dollar that the Federal Government spends today being borrowed. So as we make these cuts, whether it is done by the committee that I propose or through some other legislation, it is critical that we have the valuable information about the effectiveness of programs and act on that information to better manage our Government. So I thank the Chairman and the Ranking Member and the witnesses today for being here.

I would like to, if I could, ask a question regarding a proposed deficit reduction committee to look at wasteful spending on a biennial basis. The first question I have is: Do you believe that Congress needs institutional reforms to consider and act on performance reports like those required by GPRA and from GAO and others? Are there things that need to be done to make Congress more responsive to some of the information that is produced by these various reports?

Hon. DODARO. Well, in the past there have been various commissions and special committees and things that have been instituted that have proven to be effective in dealing with some of these issues. So I think our problems right now are so significant in terms of the unsustainable fiscal path that we are on and the need to take action across the range of opportunities that Congress should consider all options in order to effectively deal with that situation, and also to consider new rules on the budget. We have recommended that some new rules be considered to make sure that there is discipline in the budget process and that it gets implemented as intended through the budget resolution process and the appropriation bills of the various committees.

So I think there are opportunities to create new avenues, and there are also opportunities to effectively implement what currently exists.

Senator THUNE. Okay. And just for purposes of sort of a frame of reference, there was a committee back in the 1940s when they were considering how to finance World War II, and they were looking at tax increases that were suggested by a Senator from Virginia named Harry Byrd. And Congress created this Joint Committee on the Reduction of Non-Essential Federal Expenditures, and that was sort of the template for what I am proposing. That Committee was in existence for about 30 years and did a lot of good in terms of winding down programs that were no longer efficient and effective. And it strikes me at least that we need something like that in Congress today that will impose a discipline, that will put Congress in a straitjacket, because Congress has not, in the past at least, demonstrated the political will to make a lot of these hard decisions.

And so this joint committee—which would be ten Democrats, ten Republicans, ten House Members, ten Senators—would have to produce every other year. And then, of course, I propose a biennial budget, too, so there would be every budget cycle a series of recommendations that would get expedited consideration on the Senate floor and get a vote.

Hon. DODARO. Senator, what I would say, in addition to what I said earlier, is when these special entities would be created, my suggestion would be to be very clear as to what the jurisdiction is of those committees versus the existing committees that are in place to avoid any confusion, and the fact that the Congress would then be making an institutional decision that would be in the framework of the current committees going forward so that there is an ability to act on whatever is done.

Senator THUNE. Right, yes. And there would have to be—you would have to have a way of getting expedited consideration on the floor to ensure that there would be an up-and-down vote on the committee's recommendations. Yes, if you get kind of bogged down in the quagmire of all the other jurisdictions of the committees, it would never work.

One other quick question, if I might. I see my time is expiring. But your organization and others put out a number of reports and findings on Government performance and results. Could you outline a few suggestions that would make this information not only easily accessible but more understandable to the American people? One of the problems that I think we have is Government is so big and to most people, I think, sort of abstract that it is very hard for them to sometimes not only access their Government but I think understand the language that gets used in explaining a lot of this. And so sometimes I do not think the American people have an appreciation for the dimensions of the problem we face and what it is going to take to deal with it.

So do you have any suggestions about how we could make the information more accessible and more understandable to the American people?

Hon. DODARO. Definitely. I think that the provision in the GPRA Modernization Act about publishing this information on a website to make it available is good. We have watched and we have observed the Recovery Act website, and the USAspending.gov to try to put more information out in the public domain. Our concern has

been it needs to be reliable information that is put out and complete information and understandable. So the avenues of technology are there that can help better explain this to the people, but there needs to be reliable information that is posted and it needs to be complete and clear. And so we have spent a lot of time on doing that. We try that with our reports as well. And we are getting a lot of attention. This overlap/duplication report we just put out on March 1st, we had 90,000 people who downloaded that report on the first week. That is 3 times more than any other GAO report we ever put out in history. So I think there is an appetite for that. We are trying to do our part with our reports. The Government could do better and make more use of available technologies to do that.

Senator THUNE. Thank you. Those platforms I do think have given people a portal to information that they never had before. It has been very useful. I think people will have a lot more access to it.

Thank you, Mr. Chairman.

Chairman WARNER. Let me just add, I am going to go to Senator Whitehouse. We have got about 8 minutes before the vote. I am going to let him ask his questions, and then he will gavel the hearing to a slight recess. I will go vote for both and come back, and, Mr. Dodaro, I would like to still ask you a couple questions.

As a former Governor, Senator Thune, I like the idea of a biennial budget. I like it a lot better than our current approach, which seems to be a biweekly budget. [Laughter.]

Chairman WARNER. So, with that, Senator Whitehouse, do you want to chair until you finish your questions, gavel into recess? Then I will be back.

Senator WHITEHOUSE. I will do that.

Chairman WARNER. Mr. Dodaro, I really want to ask you a few questions.

Hon. DODARO. Okay.

Senator WHITEHOUSE [presiding]. I have two questions, Mr. Dodaro. Maybe we will get into others depending on how the time goes. We had a member of the President's Cabinet come before us a little while ago. I do not think I can be very specific because it was in one of the classified sessions that we have. But in the context of that meeting, the question of the amount of reporting that the agency in question had to do came up, and the Cabinet official indicated that they were going to take a hard cut at all of this because, I think as those of us who have been around even a little while have recognized, it is very easy to pass a reporting requirement for some bureaucracy that might even make some sense at the time, but 4 years go by, 6 years go by, 10 years go by, the issues is by the boards, and yet somebody in that Department has to sit there and write that darn report every year and do the research and have it sent up here where nobody reads it and so forth. And I am wondering what you feel about how big a burden stale and unnecessary reporting requirements constitute for our Federal executive branch and what means might be appropriate for stripping through them, perhaps something like Senator Thune has suggested, a review committee. I think we would probably have to institutionalize it if we are going to make it a lasting effect.

Hon. DODARO. Yes, there are two things. One, the provisions that are in the GPRA Modernization Act do require, I think, after a period of time the identification of duplicative reporting requirements and proposals to eliminate them. I think a couple things are real important here. One——

Senator WHITEHOUSE. I would go beyond duplicative. Some of the information is just no longer of interest.

Hon. DODARO. Well, that is what I was going to mention. Number one, I think Congress has to be clear on what it needs.

Senator WHITEHOUSE. Yes

Hon. DODARO. I think there also has to be a look at why the reporting requirements were put in in the first place. My experience has been, having looked at things over several decades now, typically it is because the executive branch was not forthcoming or clear initially or give Congress due information that could explain what they were trying to do. So the reporting requirements get in place. You are exactly right. It is a Catch–22 situation, and it goes on over a period of time. And it in many cases may not be serving the real purposes.

So I think clarity on the part of the Congress, candor, and constructive and recent information from the executive branch to the Congress could help heal a lot of these issues and be done in a more efficient manner.

Senator WHITEHOUSE. And would you agree that there is a real opportunity cost to it, given fixed resources in Government, that somebody who is busy writing an unnecessary and a to-be-unread report could actually be addressing a matter of real consequence for the country, but is trapped by the legal requirement that they have to do this report?

Hon. DODARO. Yes, I definitely think there are opportunities there. I know in our own case we identified mandates that the Congress had put on us that we do not think are necessary for us to do work on anymore and write reports. And we regularly come before the Congress and ask for those mandates to be eliminated or to be at least reduced over time.

So I do think there are opportunities. You are on a good topic.

Senator WHITEHOUSE. Senator Johnson has gone off to vote, but he comes to us from the private sector, and in the private sector, if you run a business and you are able to achieve an efficiency in your process or a reduced cost, the value of that achievement goes straight to you. It goes 100 percent to you. It goes to your bottom line. It goes to the shareholders who it is your duty to represent. There is a very strong feedback loop of positive reinforcement for that kind of behavior. That positive feedback loop is less present in Government. In some cases it is even a negative feedback loop because if you save enough money, that just means your budget gets stripped by that much in the next budget cycle.

I am wondering what you have seen either at the Federal or State level by way of examples of programs or pilots that try to create that kind of positive feedback loop for efficiencies and savings for a Government bureaucracy so that they are motivated to squeeze out those kinds of changes. In the past, you know, the sort of apocryphal story is that rather than do that, you know, the Park

Service will propose to close the Washington Monument and do the most unappealing possible thing in order to defend its budget.

What are the mechanisms that you have seen that help turn that dynamic more to match the private sector dynamic?

Hon. DODARO. Well, I think, first of all, you are completely right that the incentives are out of whack, if you will, and there needs to be more incentives for agencies to be able to do it. There have been some experiments in time in Government using private sector models, like gain sharing, for example. If there are productivity improvements, there is an opportunity to reinvest some of it back, but——

Senator WHITEHOUSE. If I could interrupt you, because I have just been given the warning they are about to close the vote.

Hon. DODARO. Okay. will provide something for the record.

Senator WHITEHOUSE. But if you could provide that in a written response for the record.

Hon. DODARO. I will.

Senator WHITEHOUSE. And we will go into probably, let us say, a 5- to 10-minute recess that will allow Senator Warner to return and reconvene. So we are recessed for 5 minutes.

Hon. DODARO. Thank you.

[Recess.]

Chairman WARNER [presiding]. My apologies, but the audience will be, I think, happy to know that in one more enormous evidence of the bipartisan nature of the Senate, I think the first vote was 99–1 or 98–1, and the second was going to be 99–0, so you can see we just made major policy.

Let me come back to two questions, Mr. Dodaro, and, again, thank you and thank you for staying around, and we will move, after my questions, to the next panel unless—I think Chairman Conrad may be coming as well.

The first question is: In your, I think, very good report about duplication and when you look at also GPRA, is there a way that we can put that early-warning signal out there as Congress initiates new programs, new solutions, so that there is some kind of indicator that goes on before we start this new program, know how many that are already doing what appears to be the same purpose or perhaps some balancing there that takes place that does not seem to take place at this point?

Hon. DODARO. There is definitely a need for that. I think there has been some limitations on the ability to do that. For example, there is really not a complete inventory of all existing Federal programs that everybody, agrees on. So the inventory that you would check would have to be complete and reliable.

Number two, in a number of areas we found, there were authorized purposes within a broader program that overlapped. So you would have to check not only against individual programs that would have similar goals, but against other programs whose authorized uses might be duplicative of the creation of a new program and need. But I definitely think it makes sense; it is a prudent management practice that should be put in place. And I think it could do the early warning that you suggest.

Chairman WARNER. Where would that function lie? Where would you suggest? Since certain programs may come out of one author-

izing committee. It might fall into an agency area that actually has an overlap in another. Who should be that early-warning system?

Hon. DODARO. Well, I think it is logical for the Office of Management and Budget (OMB) to play that role since they have a large portfolio and the ability to look over and tap into the entire executive branch function. And then there is obviously, the Congressional Budget Office (CBO) as another function that is part of the scoring process. And there have been people at times who have asked that GAO play that role, but we really are not in the business of creating the inventory in the first place.

Chairman WARNER. What about—one of the things back on your overlap study, I recall this Committee last year tried to do an effort to look at those programs that both the Bush administration and the Obama administration, OMB had indicated for program elimination. It seemed like that should be the lowest hanging fruit. You know, unfortunately, while it got some support, it did not come to pass, which brings us to the point that, you know, every one of us elected officials love to be there when we cut the ribbon to start something, no one wants to be there necessarily when we close it down or consolidate. Consequently, we really, if we are going to take the good work that your organization did on overlap and duplication, we have got to show some early wins.

You mentioned in your opening testimony that you had some ideas about how we might proceed on some early wins.

Hon. DODARO. Yes.

Chairman WARNER. I would love you to share that with me.

Hon. DODARO. Yes, very much so. There are a number of areas that overlap that we have identified with areas that the administration has made proposals on as well. For example, in the teacher quality area, they made recommendations to consolidate 38 programs into 11, and so I think that is an opportunity, in the reauthorization of the education legislation, to get that done early. In the employment and training area, they have recommended a number of programs for consolidation. That is another opportunity. Proposals for surface transportation, for their reauthorization, include a lot of consolidation of those programs, which we mentioned are 100 different programs instituted over a period of time. So I think those are clearly there.

There is a provision that we point out about the Social Security Administration in terms of having pension offset for spouses of State and local employees that IRS could gather information, and save funds through that information. The estimates range from $2.4 billion to $2.9 billion that could be saved over a 10-year period just by the Congress authorizing IRS to put another line on a form that they already use. That is easy money, and the administration is making that proposal, and Congress would just have to act there.

In the Customs area, we found, due to temporary increase in the fee, there is $640 million sitting at the Customs Service in this account, and it is not clear how that money could be used. It is there.

We mentioned the ethanol area in terms of the tax credit overlap with the renewable fuel standard. There is an opportunity there to take action. That tax credit last year was estimated to cost $5.7 billion.

The military medical command is another area where I think there are already proposals and cost estimates. Depending upon how the military acts, you could save from $200 to over $400 million a year in that area.

I think the administration has already proposed to increase the amount of contracts that are subject to competitive bidding. If the Congress weighs in and emphasizes and tracks that, that is another area. There is about 31 to 35 percent of all contracts that have been let in recent years that have not been competitive, and I think the Government is not getting the full advantage of that competition.

So those would be my opening bid, Mr. Chairman.

Chairman WARNER. Well, we would—let me state for at least this member, and I am sure members on both sides of the aisle, I look forward to working with you on seeing if we can move those ideas into specific policy proposals that I think the mood in the country and the mood in this Congress is to act on those.

Let me ask one last question here. One of the things in what we tried to do with the GPRA bill was recognize that in these kind challenging deficit times, you have got to work actually collaboratively with your workforce and invite their ideas, recognize that we also need to not simply add burdens as we add these quarterly reporting requirements, but actually see if we can eliminate some of the burdens on the reporting, have them get better focus in terms of priority goals.

One of the things that I can recall from my tenure as Governor is when we looked at consolidation, there was always a concern that all of the savings that might be accomplished would be then taken away and then used for other programs or other initiatives. Have you looked at all or thought at all about the idea that some notion that if you were consolidating, some of those savings could be reinvested back at least in the policy goals or upgrading of technology or other tools to make sure that you really get buy-in from the workforce on helping you go through this process?

Hon. DODARO. Yes, I think it is important to have the proper incentives in place. I was talking with Senator Whitehouse earlier when you stepped out about the incentives not being in proper alignment to achieve those type of objectives. I would like to go back and take a look at what we have done. I cannot recall anything that we have done recently on that very important point. I will provide you something for the record. We can discuss it later. But do think it makes sense.

Hon. DODARO. But also we need to make sure in getting the efficiencies that, we do not reinvest in something that is not a higher priority. And I do think our problem is so big right now and we are on such an unsustainable path that we have to be prudent in making any reinvestments. And while it is an incentive, I think it has to be balanced against the need that we have right now to put things on a more prudent fiscal path.

Chairman WARNER. I would concur with that. I do think there may be some area, though, that—you may have a policy area where there is a legitimate goal, and if your program is getting folded in, at least some of those resources continue on that policy goal even if the program is being eliminated.

Hon. DODARO. Yes, but basically the incentives right now are to spend the money.

Chairman WARNER. Right.

Hon. DODARO. Not to save the money.

Chairman WARNER. Right.

Hon. DODARO. And it is going to require cultural change, and I think there has to be a resistance, to providing mixed messages in order to change that culture.

Chairman WARNER. Well, thank you. I want to again thank you for your testimony here this morning. I want to thank you for the good work you did on the report as well as your comments on the GPRA bill. We look forward to working with you on moving forward on the policy of some of the duplication elimination, and we also look forward to continuing to work with you on the implementation of GPRA. I think your work and the implementation of GPRA fit very nicely together.

Senator Johnson, do you have any other questions for this witness?

Senator JOHNSON. No.

Chairman WARNER. We will move to the second panel.

Hon. DODARO. Thank you very much, and we look forward to working with you.

Chairman WARNER. Yes, sir.

We will now move to our second panel, and, again, I appreciate Senator Johnson coming back for this hearing, for this second part of the hearing. We may have a new great partner. This is an area where I find sometimes our colleagues like to make high-flung statements about efficiency and effectiveness, but very quickly their eyes glaze over as you dig into management issues, and someone who has had the kind of background that Senator Johnson brings, managing companies, seeking out efficiencies, trying to make sure that an organization is more productive, is a real asset in this body. So I appreciate him coming back.

On the second panel, we are going to be hearing from two good friends and two individuals who bring an enormous expertise in this area around Government performance and management: John Podesta and Robert Shea.

Mr. Podesta is currently president and CEO of the Center for American Progress, which he founded in 2003. He served as Chief of Staff to President Clinton. He co-chaired President Obama's transition, and both John and his organization have done an enormous amount of work in this space, and I welcome his testimony and his appearance today.

We are also going to hear from Robert Shea, whom I have also had the opportunity to work with and get his advice on some of these issues through the development of GPRA. Mr. Shea is a principal of the Global Public Sector Team at Grant Thornton. He was previously the Associate Director for OMB during the administration of George W. Bush. He managed OMB's internal affairs and led President Bush's Performance Improvement Initiative. Mr. Shea also administered the Program Assessment Rating Tool and ExpectMore.gov and led interagency collaborations in the area of food safety and implementation of the Federal Funding, Accounting, and Transparency Act.

So, gentlemen, welcome, and we will start with John.

STATEMENT OF JOHN PODESTA, PRESIDENT AND CHIEF EXECUTIVE OFFICER, CENTER FOR AMERICAN PROGRESS

Mr. PODESTA. Thank you, Mr. Chairman, and let me at the outset thank you and Senator Johnson for digging into this, the GPRA Modernization Act of 2010, probably not the most sexy topic in the world, but it is really critical, I think——

Chairman WARNER. I take some offense at that. [Laughter.]

Mr. PODESTA. [continuing]. To increasing the productivity of our Government and deal with the very serious challenges that we have with respect to the deficit and the debt. Let me begin there.

Like most of the members of this Committee, I have talked myself blue in the face about the need to stabilize the debt in the next few years and to begin to return to balance over the long term. And while we may disagree to some extent about how we went from record surpluses when I walked out of the White House to record deficits when President Obama walked into the White House, we certainly agree that it is time to make some tough decisions, and those tough decisions ought to be smart ones as well, particularly about where to cut spending so that we continue to see the recovery strengthen in the short term and lay the foundation for economic growth and job creation in the long term while bringing down our long-term deficit. And that I think is going to require smart decisions, and it is going to require a scalpel rather than a meat axe. And that is where performance comes in. We need to better measure return and immediately cut programs and efforts that are ineffective, that are redundant, that are low priority, as Mr. Dodaro testified, and we should support efforts that are working well, that boost American competitiveness, create jobs, and help us reach our goals on critical priorities, particularly education, innovation, health care, and energy transformation.

That is not just rhetoric. I think for us at the Center for American Progress we have put forward a plan that put the Federal budget into primary balance by 2015, making over $130 billion in spending cuts by that fiscal year. We are pleased that President Obama is exploring and has directed the Office of Management and Budget to work on consolidating related Federal agencies to strengthen American competitiveness, to increase exports, and deal with the disparate agencies dealing with trade, something we recommended in December.

Enhancing Government effectiveness and improving productivity is not always about cutting budgets, of course. It is about getting better results for the public. For example, we have recommended combining and streamlining overlapping and duplicative programs, as the GAO also did in its recent report. Our objective in such a strategic consolidation and time saves money, but the point of streamlining for results, particularly when the beneficiaries are the neediest Americans, is not only to cut but to redirect savings to more effective uses.

I would like to just give you a couple of examples from our work of where we think closer attention to performance and productivity can have important results. To demonstrate how the Government can use performance data to guide policy decisions, we recently

launched a ground-breaking website that provides return on investment adjusted for demographics, data on virtually every public school district in the country so you can actually measure dollars in and performance out. We also have targeted inefficient and ineffective tax expenditures. We are releasing a report on it this this week identifying the most wasteful corporate tax expenditures, what I would refer to as "tax earmarks" really in the Tax Code. Boosting productivity and cutting operational waste will yield still more savings, particularly in areas such as information technology, where we estimate we could save over $16 billion a year. Improper Medicare payments and procurement, again, where we have estimated that you could save nearly $400 billion over 10 years just by improving and using better business practices in the way the Federal Government buys goods and services.

The GPRA Modernization Act, if implemented well, can help on all these things—root out ineffective spending, cut operational waste, improve results for the American people. My written statement goes into some detail about implementing this important law, but let me just highlight two things very quickly.

One is if agencies do not get their goals right, nothing else will work. You have made this point in your opening statement, Mr. Chairman. No agency should set more than five high-priority goals, and I would say that is probably too many for most of the Federal agencies. One of those goals should target operational savings and be assigned to the new Chief Operating Officer who should have the decision making and budget authority to achieve it. These goals should state in clear, quantifiable terms what the agency will achieve for the American people, how much money it will save by cutting waste in procurement, information technology, and operations.

The new law's other important feature calls for these cross-government goals. President Obama I think could use this opportunity to communicate his administration's government-wide priorities. Right now we have 128 government-wide top-level priorities. That is way too many. He needs to get it down. I think we have seen experiences in other countries, particularly in the U.K., where you look at a series of clear, targeted goals with clear direction from the top, it produced tremendous results.

And then let me close by saying Mr. Shea and I have worked together on this topic. This is clearly a bipartisan approach and a bipartisan effort, and he along with my colleagues are here, Reece Rushing and Jitinder Kohli, who direct our Doing What Works project, I think are convinced that the Congress has an important role in overseeing this. But the goal-setting feature that I mentioned, particularly these high-level, cross-cutting goals of the administration, are really critical, and I urge the administration to move forward with that.

Thank you.

[The prepared statement of Mr. Podesta follows:]

Center for American Progress Action Fund

Testimony for the U.S. Senate Budget Committee Task Force on Government Performance

Senator Mark Warner, Virginia, Chair

on

"Modernizing Performance: Using the New Framework"

by John D. Podesta, President and CEO, The Center for American Progress Action Fund
10:00 a.m., March 16, 2011

Mr. Chairman, members of the task force, I am pleased to be here today to celebrate enactment of the GPRA Modernization Act of 2010 and talk about the implementation challenges ahead. But first I want to talk about the broader government performance agenda, of which the new law is an important piece, and how it relates to our fiscal troubles.

As you know, the Congressional Budget Office is projecting a nearly $1.5 trillion federal deficit this year. The record-breaking size of this year's deficit is mostly a product of past fiscal mismanagement combined with the enormous impact of the Great Recession. But that is behind us now. Virtually everyone agrees that we must return to balance over the long term.

That will be difficult under any circumstances, and more so if we act rashly. Economic recovery is underway, but it remains fragile. Harsh "austerity measures" in the United Kingdom may be pushing that country back into recession.

Nevertheless, we need to consider all of our options for deficit reduction. And though spending is only one side of the equation, we are facing hard choices and cuts are part of the solution.

Congress and the executive branch will have to make smart decisions about where to make cuts so that we continue to see growth and job creation while bringing down our long-term deficits. This requires, as President Obama has said, a scalpel, not a hatchet.

We should immediately cut programs and efforts that are ineffective, redundant, or low priorities. And we should support efforts that are working well, that boost American competitiveness and create jobs, and help us reach our goals on critical priorities such as education, health care, and energy.

In a CAP report this week, we identify the most wasteful tax expenditures and provide a blueprint to saving tens of billions every year by rooting out the lowest-performing tax "earmarks" to special interests.

Still more savings are possible by boosting government productivity and cutting operational waste.[9] The federal government could save $400 billion over 10 years by improving the way it buys goods and services, according to a CAP report released in November.[10] The Obama administration has also set an ambitious goal of reducing improper payments in programs such as Medicare by at least $50 billion by 2012.[11]

Better use of information technology is a key part of the solution in combating waste, fraud, and abuse. The Veterans Administration, for example, used the administration's new IT Dashboard to identify $200 million in overdue or overbudget IT projects. And Recovery.gov transparency is credited for significantly reducing fraud complaints, down to less than 2 percent of contracts and grants.

The federal government, unfortunately, has not always been so smart about information technology. As former administration officials Peter Orszag and Rahm Emanuel put it, "Too many government IT projects cost hundreds of millions of dollars more than they should, take years longer than necessary to deploy, and deliver technologies that are obsolete by the time they are completed."[12] As a result, government has failed to match the dramatic productivity gains achieved by the private sector. The good news is that we have significant room for improvement—and savings.

The administration's move toward cloud computing holds much promise in this respect. The federal government now operates about 1,100 data centers. Networking these data centers in a shared "cloud" would allow us to reduce their number and save money on electricity and storage. The British government predicts it could cut its IT budget by 20 percent by adopting cloud computing and other related IT improvements. The U.S. government would save $16 billion a year if it did the same.[13]

I believe the GPRA Modernization Act, if implemented well, can help us root out ineffective spending, cut operational waste, and improve results for the American people.

I'll go into more detail later about how to best implement this important law, but first I want to draw your attention to the act's emphasis on setting goals—because if agencies don't get their goals right, nothing else will work.

Under the Government Performance and Results Act of 1993, agencies have been setting myriad goals covering almost every area of work. The current administration wisely asked agencies to narrow their number of goals. But there are still too many so-called "High Priority Performance Goals"—128, to be exact—and many are decipherable only

Key benefits of the GPRA Modernization Act

The GPRA Modernization Act provides a strong framework for moving forward. In particular:

- The act forces federal agencies and new political appointees to own their goals by aligning the timing of the strategic planning process with the presidential cycle. No longer can plans be written off as products of a previous administration.

- The act requires each agency to set clear goals over a two-year timeframe. Political appointees typically hold their positions for a short time. The two-year timeframe helps ensure that appointees will be accountable for achieving agency goals.

- The act requires goals to be set across government as well as within agencies. This provision will help make sure that agencies work together in setting and achieving overlapping goals. The administration's High Priority Performance Goals initiative lacks this feature.

- The act requires agencies to seek Congress's input in setting goals. Under your leadership as Virginia's governor, Mr. Chairman, the commonwealth's executive and legislative branches worked together to set "goals for government" as part of the Virginia Performs initiative. The act does not go this far, but it does encourage a more collaborative approach.

- The act requires agencies to identify, for each high-priority goal, the programs, tax expenditures, and regulations that contribute to the goal and what they contribute. This process will help identify programs and approaches that are most effective. It will also help make sure federal agencies are focused on delivering results, and not just administering programs.

- The act requires agencies and the Office of Management and Budget to conduct performance reviews at least once a quarter to track progress toward goals. The hope is that agencies will use these reviews to adjust programs and approaches as they go along. Such a process helps make sure decision-makers see and use performance data, increasing the chances that a goal will be accomplished.

- The act requires OMB to make key performance data available online in a single place. Such transparency can empower the public and provide a powerful incentive for agencies to improve their performance.

- The act codifies President Clinton's designation of deputy agency heads as chief operating officers who are responsible for management and performance issues. This statutory responsibility will help ensure that nuts-and-bolts operations are not ignored.

What are the characteristics of good performance reviews?

Sir Michael Barber set up the world's most renowned performance review system under former British Prime Minister Tony Blair. CAP Senior Fellow and former U.K. official Jitinder Kohli saw firsthand the benefits of this system. He has shared his experience with the Office of Management and Budget and federal agencies through a series of training sessions.

CAP also released a paper yesterday that looked for lessons at NASA, the FAA, the VA, and the IRS, which each have successful performance review processes that have survived transitions in political leadership.[14] We hope this work will help agencies answer a number of important questions they now face. Among them: Are quarterly reviews sufficient, or should they be more frequent? Who should attend? What kind of incentives (such as linking employee pay to performance) should be built into a review's design? Who should lead the review? And what kind of metrics should be used to track progress? This task force should look at what agencies decide, see what works, and help make sure agencies learn from each other.

How do we change the way agencies think?

The GPRA Modernization Act wants agencies to change the way they think—to put the focus on evidence and results over process, to be fast and creative in solving problems, and to look beyond narrow silos. This requires a culture change. The act will change what agencies do, but culture is more stubborn. Leaders in the administration and in Congress must stay vigilant and reinforce this culture change every day.

This can be as simple as asking the right questions. CAP yesterday released a major report that offers practical tools for the design and evaluation of programs.[15] These tools ask decision-makers to answer a series of questions that force them to think about on-the-ground results. If these questions are asked enough, it should begin to feel less forced and more natural. When this happens, culture change may take hold.

How do we keep Congress engaged?

Congress passed the Government Performance and Results Act in 1994 and then acted as if the job was done. There was little interest in implementation or the performance information that was subsequently generated. The expression "use it or lose it" applies here. If Congress does not seek better performance information, agencies will not deliver it. And no fix in the new law will change this.

To be sure, there should be more opportunity for Congress to get involved. The executive branch must seek Congress's input in setting goals. But Congress still has to use this opportunity.

I believe this task force has a critical role in making sure that Congress plays its full part in shaping goals and ensuring the act is implemented in a way that is relevant to congressional decision-making. As part of this, it will be important to reach out to other members and bring their input to agencies.

How do we get the most out of the Chief Operating Officer?

Deputy agency heads, as chief operating officers, will be responsible for implementing the new law and for management and performance issues generally. This is a broad mandate that needs further discussion. I believe these COOs can help link the management side with the budget side. Above, I identified two ways to do this: First, COOs should be responsible for making sure performance information is useful to budget decisions, and second, they should have the necessary budget and decision-making authority to meet goals for operational savings.

Consider the opportunity on procurement. CAP Visiting Fellow Raj Sharma released a report in November estimating that federal spending could be cut by as much as $54 billion a year just by improving how government buys goods and services.[16] He notes that procurement officials with no control of budgets or decisions that lead to waste are in charge of reform efforts. This is not good enough. Each agency's COO should lead a procurement-reform SWAT-style team that is accountable for achieving the savings we know are there.[17]

Conclusion

The administration is fortunate to have you, Mr. Chairman, and other members of this task force as partners in building a more efficient, effective government. Government reform efforts fail when Congress is not invested and we lose focus. That's why your leadership and the work of this task force are so important. And that's why the passage of the GPRA Modernization Act is so significant.

To be sure, many challenges remain—and I've listed some critical ones in this testimony. But I believe with your leadership and the commitment of others in Congress and the administration, we can rise to meet these challenges.

Thank you for the opportunity to testify.

Chairman WARNER. Thank you, Mr. Podesta.
Mr. Shea.

STATEMENT OF ROBERT SHEA, PRINCIPAL, GRANT THORNTON, LLP

Mr. SHEA. Thank you, Senator Warner, Senator Conrad, Senator Johnson, for having us here today. I am delighted to work with the Center for American Progress—on this topic. [Laughter.]

I want to make sure some of my friends on the other side are hearing that loud and clear.

I am proud to represent Grant Thornton, which is providing expert performance management services to the public sector and the Federal, State, and local governments. I applaud Congress and the President for passing the Government Performance and Results Modernization Act, which really enhances the tools we have at our disposal to improve the Government's performance.

If we want to make genuine strides in this area of performance improvement, Congress and the executive branch must make use of all the performance data it is getting in its decisionmaking. Agencies must view stakeholder consultation as a genuine source of feedback. Perhaps most importantly, Congress and the executive branch should appoint leaders who understand the power of performance information and have experience using it to transform organizations.

GPRA was a key milestone in the transition of Government from one that measures activities or outputs to one that measures outcomes and evaluates impact. We have come a long way from satisfying ourselves with measuring things like number of regulations issued or grants made, though we are not where we should be. Despite progress, not enough of our time in Government is focused on assessing whether goals are being achieved and, if not, what to do about it. Congress and the executive branch are focused more often on policy and politics rather than on the sometimes—maybe always—tedious yet important work of managing and monitoring program performance.

Using performance information in decisionmaking does not come naturally to the Federal Government. As resources grow scarcer, performance information should be used in the budget process to ensure investments have the greatest impact. The GPRA Modernization Act makes it clear that agencies are responsible for using data to manage and report data in a transparent manner for public consumption.

According to a 2007 survey by GAO, managers report that, despite having more performance measures, the extent to which managers use the information remains relatively unchanged after about a decade of working on it. Having a meeting to discuss progress is no guarantee that sufficient actions will be taken to improve performance.

Agencies and their stakeholders, including Congress and 0MB, need a disciplined approach to ensure clear, concrete improvement actions are identified and, further, that individuals are held accountable for implementing them.

If Congress and the administration do not demonstrate this commitment to understanding and using information, agencies will

continue to comply with the new requirements but miss the constructive benefits of meaningful performance management practices.

One of the widest gaps in the use of performance information today is in the budget process. I cannot imagine a better Committee than this one to take the lead on assessing and improving the extent to which agencies, the President, and Congress are using performance information to allocate scarce resources. Areas where duplication exists present a great opportunity to do this.

The executive branch shares a responsibility not only to demand clear and useful performance information, but also to ensure agencies are collaborating with their stakeholders and each other to reduce redundancies, increase efficient delivery of program outcomes, and improve their collective performance. The President, as you know and as we have discussed, in his State of the Union Address, mentioned the 12 different agencies that deal with exports and the five that deal with housing policy. As you also know, that complexity is just the tip of the iceberg.

GAO's most recent report puts in sharp relief the magnitude of duplication and overlap among Federal programs and agencies. I am not optimistic that the fundamental reorganization of Government the President eventually proposes will be successful, but I think the GPRA Modernization Act presents a promising framework for improving the coordination among like programs. Provided Congress takes an active role ensuring these provisions' implementation, these requirements can be powerful incentives to improve coordination among duplicative programs.

A couple of other points. Although use of performance information in day-to-day management is important, programs sometimes require a more rigorous evaluation to ensure they are having the intended impact. The Obama administration's evaluation initiative promises to vastly expand the body of evidence we have with which to judge what works and what does not. Many programs, when subjected to rigorous evaluation methodologies, will not live up to their promise. But without such evidence, programs are implemented blindly without knowing their intended impact.

Perhaps the most critical element in an organization's success is leadership. Leaders who understand the difference between what is urgent and what is important can keep organizations from getting distracted and instead keep them focused on implementing effective performance improvement strategies.

Grant Thornton, in collaboration with the Partnership for Public Service, is conducting a survey of performance improvement officers. The views of these experienced leaders will be an important input into what steps should be taken to enhance the effectiveness of the Government's performance management practices. The Obama administration and Congress must ensure that those positions are filled with experienced individuals who have managed organizations using data to drive change and improvement.

Like the performance management initiatives before them, the GPRA Modernization Act is an important milestone in our never-ending quest to make Government more efficient and effective. Assigning accountability for improved performance and outlining transparency requirements can go a long way toward improving

program success. Without active, persistent oversight from Congress and the executive branch, progress will be sporadic and fleeting, if at all. And without strong and experienced leaders, progress may really be limited, if not impossible.

Thank you very much for inviting me today.

[The prepared statement of Mr. Shea follows:]

Statement of

Robert Shea
Principal
Grant Thornton LLP

before the

Committee on the Budget
United States Senate

March 16, 2011

For more information, contact:
Robert Shea
(703) 637-2780
Robert.Shea@gt.com

Thank you for inviting me to testify this afternoon.

My name is Robert Shea and I am a Principal of Grant Thornton LLP, one of the six global audit tax and advisory organizations. I work in Grant Thornton's Global Public Sector (GPS), based in Alexandria, Virginia. Our mission is to provide responsive and innovative financial, performance management, and systems solutions to governments and international organizations. Grant Thornton GPS provides expert performance management advice to major federal departments and agencies, as well as to state and local governments.

I applaud the Congress and the President for enacting the Government Performance and Results Modernization Act of 2010. This new law enhances the tools we have to improve the government's performance — measurable results achieved on behalf of the American people. The GPRA Modernization Act of 2010 takes great steps to help agencies improve their performance through:

1) The establishment of the Performance Improvement Officer;
2) The requirement for greater transparency in reporting;
3) The focus on practical use of performance information; and
4) The attention to data completeness and reliability.

If we want to make genuine strides in this area — performance improvement — Congress and the executive branch must demand valuable, outcome-oriented performance data and make use of it in their decision-making. Agencies must view stakeholder consultation as a genuine source of feedback, thereby enlisting them in the quest to improve. Perhaps most importantly, Congress and the executive branch should appoint leaders who understand the power of performance information and have experience using it to transform organizations.

GPRA laid a foundation for outcome-oriented government

Enactment of GPRA in 1993 was a key milestone in the transition of government from one that measures activities or outputs to one that measures outcomes and evaluates impact. We've come a long way from satisfying ourselves with measuring things like number of regulations issued or grants made. Today, more often than not, it is clear what outcomes agencies are trying to achieve and how they will measure success along the way. Although it may seem obvious, traditionally agencies have had difficulty setting ambitious outcome-oriented goals — either because measuring outcomes is hard and requires coordination across multiple programs or departments, or because being accountable for difficult-to-achieve outcomes is scary.

Early in the implementation of GPRA, these concepts were unknown to government agencies. For many, they are still difficult to grasp. As a refresher: *outputs* are the deliverables produced by programs, while *outcomes* are the important results (or impacts) these deliverables achieve. The National Highway Transportation Safety Administration, for instance, issues grants, but its success is measured by how many fewer people die in automobile accidents each year.

Despite the progress made as a result of GPRA, not enough of our time in government is focused on assessing whether goals are being achieved and, if not, what to do about it. Congress and the Executive Branch are focused more often on policy or politics, rather than on the sometimes tedious, yet important work of managing and monitoring program progress. This reality frustrates

agency and department leadership producing reports, data, and analysis, because it means they invest considerable time, energy, and money on information no one will use.

Agencies, Congress, and the Administration must use performance information

Using performance information in decision-making does not come naturally to the federal government but responding to crises and debating policies and budgets do. However, our deliberations would benefit from the use of performance information. As resources grow scarcer, performance information should be used in the budget process to ensure investments have the greatest impact. Performance information should also be used in the authorization and oversight process to hold programs and agencies accountable. Further, performance information is useful in assessing and improving government contracts, grants, and personnel. There is no limit to the use of reliable performance information given that federal agencies have been collecting and reporting on some form of performance information for the better part of a decade.

The GPRA Modernization Act of 2010 rightly focuses on the responsibility of top leadership — the President, the Office of Management and Budget, agency heads, and the Chief Operating Officers — to set strategy and articulate goals. However, the law also makes it clear that agencies are responsible for using data to manage and report the data in a transparent manner for public consumption. The Senate report on the bill describes one of the relevant provisions: "This section also requires that, at each agency, the head of the agency and the agency's COO [Chief Operating Officer], with the support of the agency PIO [Performance Improvement Officer], conduct an analogous quarterly review to review priority goals with the appropriate goal leaders."[1] This quarterly review process can greatly improve agency attention to performance, although this simple requirement is not enough.

According to a 2007 survey of federal managers, the Government Accountability Office concluded that "despite having more performance measures, the extent to which managers make use of this information to improve performance has remained relatively unchanged."[2] Having a meeting to discuss progress is no guarantee that sufficient actions will be taken to improve performance. Agencies and their stakeholders, including Congress and the Office of Management and Budget, need a disciplined approach to ensure clear, concrete improvement actions are identified, and further, that individuals are held accountable for implementing them.

Measuring progress toward outcomes often spans many years. The GPRA Modernization Act reminds agencies that they must clearly describe how performance goals contribute to the achievement of long-term, outcome-oriented strategic goals. The candid reporting of progress on these interim goals will give stakeholders a better idea of what progress is being made in the absence of more timely, outcome-oriented performance information. It is critical, however, that agencies provide the information in a form tailored to their specific stakeholders.

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[1] Report of the Committee on Homeland Security and Governmental Affairs, United States Senate; *GPRA Modernization Act of 2010*; Senate Report 111–372; 111th Congress, 2nd Session; December 16, 2010; at 17 (http://www.gpo.gov/fdsys/pkg/CRPT-111srpt372/pdf/CRPT-111srpt372.pdf).

[2] Government Accountability Office; *Government Performance: Lessons Learned for the Next Administration on Using Performance Information to Improve Results;* Testimony of Bernice Steinhardt; Report Number GAO-08-1026T; July 24, 2008 (http://www.gao.gov/new.items/d081026t.pdf).

The requirement for quarterly meetings and enhanced, transparent reporting will not guarantee that agencies adopt a more robust approach to performance management. If Congress and the Administration do not demonstrate a commitment to understanding and using the information provided, agencies will demonstrate compliance with these new requirements but miss the constructive benefits of meaningful performance management practices.

When I was Associate Director at the Office of Management and Budget, the Bush Administration was criticized for lack of consultation with Congress when it came to performance management. Despite my belief that we had taken substantial efforts to engage Congress, I was committed to doing more. So we asked each agency to engage their relevant appropriations, authorization, and oversight committees in a discussion of their performance. Agencies reported a lack of meaningful consultation resulting from this exercise. This finding emphasizes the need for Congress and agencies to meet half way. Congress needs to show a commitment to using performance information to a greater degree in its deliberations and engage agencies in the development of more meaningful performance reports. Agencies must also engage Congress and other stakeholders early and often in the performance management process.

One of the widest gaps in the use of performance information today is in the budget process. Resource allocation often suffers from an inability to justify budget requests with robust data about what taxpayers will get for the proposed investment. Since enactment of GPRA, integration of performance information in the President's and agencies' budget requests has improved. However, it's often an afterthought, using performance information to justify the request *after* decisions have been made, rather than using the information to make tradeoffs among competing programs or initiatives. I can't imagine a better committee than this one to take the lead on assessing and improving the extent to which agencies, the President, and Congress are using performance information to allocate scarce resources.

The executive branch shares a responsibility not only to demand clear and useful performance information, but also to ensure agencies are collaborating with their stakeholders and each other to reduce redundancies, increase efficient delivery of program outcomes, and improve their collective performance. The President, in his State of the Union Address, mentioned the 12 different agencies that deal with exports and the five that deal with housing policy. That complexity is just the tip of the iceberg. The Government Accountability Office (GAO) has a long history of pointing out the lack of coordination among the many duplicative program areas,[3] and its most recent report puts in sharp relief the magnitude of duplication and overlap among federal programs and agencies.[4] I am not optimistic that the fundamental reorganization of government the President eventually proposes will be successful, but I do believe the GPRA Modernization Act provides a promising framework for improving the coordination among like programs. For example, the bill:

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[3] See Government Accountability Office, *Managing for Results: Barriers to Interagency Coordination*; March 2000, Report Number GAO/GGD-00-106 (http://www.gao.gov/archive/2000/gg00106.pdf).

[4] See Government Accountability Office; *Opportunities to Reduce Potential Duplication in Government Programs, Save Tax Dollars, and Enhance Revenue;* March 2011; Report Number GAO-11-318SP (www.gao.gov/new.items/d11318sp.pdf).

- Charges the Performance Improvement Council with resolving specific governmentwide or crosscutting performance issues;
- Requires that the Federal Government Performance Plan include governmentwide goals and inventory the multiply agencies or programs that contribute to their achievement; and
- Asks the Government Accountability Office to assess implementation of, among other things, the Federal Government performance plan and priority goals requirements.

Provided Congress takes an active role ensuring their implementation, these requirements can be powerful incentives to improve coordination among duplicative programs.

Importance of accurate data

The GPRA Modernization Act enhances the requirement to ensure that publicly reported data is accurate. While encouraging greater use of performance, I caution you to be attentive to the practices in place to ensure the integrity of the information you and other stakeholders are provided. As Congress, the Obama Administration, and agencies move to use performance information in more meaningful ways — including guiding resource allocation decisions — assurance that performance data is reliable and verifiable is more critical than ever. Making decisions using unreliable data is worse than not using the data at all. Federal programs are complex and implemented with a wide diversity of personnel and partners. Getting consistent, accurate data from so many players is a challenge. Data need not be perfect, but agencies must ensure that performance information represents valid measures of a program's performance combined with accurate, complete, verifiable, and consistent data.

The promise of rigorous independent program evaluation

Although use of performance information in day-to-day (or quarter-to-quarter) management is important, programs sometimes require a more rigorous evaluation to ensure they are having the intended impact. To prove a program is working, rigorous, random, and controlled independent evaluations can isolate the impact a program is having from other factors. A recent OMB Memorandum characterized the value of such evaluations:

> *Rigorous, independent program evaluations can be a key resource in determining whether government programs are achieving their intended outcomes as well as possible and at the lowest possible cost. Evaluations can help policymakers and agency managers strengthen the design and operation of programs. Ultimately, evaluations can help the Administration determine how to spend taxpayer dollars effectively and efficiently — investing more in what works and less in what does not.*[5]

This evaluation initiative promises to expand vastly the body of evidence we have with which to judge what works and what doesn't. Many programs, when subjected to rigorous evaluation methodologies, will not live up to their promise. Without such evidence, however, programs are implemented blindly without knowing their intended impact. Only with such evidence can you begin to adjust programs to increase their chance of success. Such evidence may also provide a more legitimate basis for eliminating those programs that aren't working. When a rigorous

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[5] Office of Management and Budget; MEMORANDUM FOR THE HEADS OF EXECUTIVE DEPARTMENTS AND AGENCIES: Increased Emphasis on Program Evaluations; October 7, 2009; M-10-01.

evaluation reveals that a program is having a significant impact, these revelations should get your attention. Replicating that success should be a primary focus of the program, the agency, Congress, and the Obama Administration. The more evaluations we conduct, the more evidence we have of what's working. The more evidence we have of what's working, the more we can allocate tax dollars to the greatest benefit.

Leadership

Perhaps the most critical element in an organization's success, and one that certainly cannot be legislated, is leadership. In my experience, the key difference between a successful and less-than-successful organization is the quality of its leaders. Leaders who understand the difference between what is urgent and what is important can keep organizations from getting distracted and instead keep them focused on implementing effective performance improvement strategies. Leaders can also ensure that initiatives like the GPRA Modernization Act won't become just another compliance exercise. They are in the ideal position to harness the energy and creativity of the workforce in identifying improvements.

Grant Thornton, in collaboration with the Partnership for Public Service, is conducted a survey of federal agency performance improvement officers. The views of these experienced leaders will be an important input into what steps should be taken to enhance the effectiveness of the government's performance management practices.

Although the GPRA Modernization Act enumerates important qualifications for Chief Operating Officers and performance improvement officers, it will be incumbent on the Obama Administration and Congress to ensure that those positions are filled with experienced individuals who have managed organizations using data to drive change and improvement. Leaders with strong experience in managing successful organizations will either have direct experience with — or at least be able to sift through — the countless management improvement initiatives thrust on agencies. These abilities will enable them to put together accountability mechanisms that fit the environment in which they are working. In this way, questions of party loyalty and policy familiarity are forced to take a back seat to questions of managerial expertise and past success.

Conclusion

Like the performance management initiatives before them, the GPRA Modernization Act is an important milestone in our never-ending quest to make government more efficient and effective. Assigning accountability for improved performance and outlining transparency requirements can go a long way toward improving program success. Without active, persistent oversight from Congress and the executive branch, progress will be sporadic and fleeting. Without strong and experienced leaders, progress may be limited, if not impossible.

About Robert Shea

Robert Shea is a Principal in the Grant Thornton LLP Global Public Sector practice. He leads the firm's Cost, Budget, and Performance Management Community of Practice. Robert is a Fellow of the National Academy of Public Administration and a member of its Board of Directors.

Before joining Grant Thornton, Robert was at the U.S. Office of Management and Budget as Associate Director for Administration and Government Performance. In addition to managing OMB's internal operations, Robert led the President's Performance Improvement Initiative and administered the Program Assessment Rating Tool.

Before joining OMB, Robert served as Counsel to the Senate Committee on Governmental Affairs where, in addition to general oversight of Executive Branch management, he advised Committee leadership on the status of implementation of the statutory framework for performance-based government, including the Government Performance and Results Act and the Chief Financial Officers Act.

Robert was Legislative Director for Congressman Pete Sessions (TX) from 1997 to 1999, where he organized the Results Caucus, a group of Members of Congress dedicated to results-based management and solving many of the government's major management problems. Robert was a Professional Staff Member with the House Committee on Government Reform from 1995 through 1996. There he had responsibility for examining the economy and efficiency of government programs, and acted as liaison with the government's Inspectors General.

Robert graduated from South Texas College of Law in Houston, Texas; and received a Bachelor of Arts from Connecticut College in New London, Connecticut. Robert lives in Alexandria, Virginia with his wife, Eva, and their three girls, Haley, Hannah, and Mimi.

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Chairman WARNER. Well, thank you both, gentlemen, and in the theory of trying to be efficient I will only ask one question because those who ask little get colleagues to come back, and that one question would be: You both were involved in initiatives for separate administrations. It seems to me from the outside these are often initiatives that are announced with great fanfare and then slowly taper off. With this new tool of the GPRA Modernization Act, what are the two or three early signs we should be most watchful for in terms of making sure the administration actually implements this in a meaningful way? And what should be the warning sign if they are not? Either one of you.

Mr. PODESTA. Well, again, I think this requires senior management leadership, and I think that one of the most important efforts that needs to take place is that those chief operating officers take ownership and link budget authority to program performance, and they take ownership of the goals of the agency, that the number of goals be limited, and that they be able to report back to you as to what their success is in achieving those goals. And at the cross-cutting government-wide level, again, I would urge the OMB team and the President to limit the number of cross cutting goals. I mean, the President has already thrown out a number of them, including doubling exports in 5 years, getting back to number one in terms of college graduation rates in this country. It should be a limited number. They should be identifiable. Whether or not there is one or many agencies working on them, he needs to have people report back through OMB to him to ensure that we are on track to achieve those.

The other one in my mind is being able to deliver results on delivery reform under the health care law that is actually going to do what I think the President promised, which you worked so hard on, Mr. Chairman, to actually see delivery reform produce identifiable results to reduce the costs of health care and produce better results.

Mr. SHEA. I think you should ask yourselves whether or not you have got sufficient input into the way OMB and others are going about implementing the bill to know whether or not it meets your expectations. And I do think it will take a lot of hard, tedious, repetitive, relentless focus to ensure that they are getting it right—not perfect, but that they are right.

I agree with John that the question of senior leadership focus is really important in the agencies and from OMB. Unless somebody from the White House or senior OMB leadership is taking this seriously and investing the time it takes to get it right, it will not be successful. But you also need people with experience using data to manage organizations. There is no organization in the Government that could not stand a little transformation. And the people who have got experience doing that are who we need to look to lead these organizations, which, you know, completely dwarf the complexity of the private sector. So you ought to at least start with that kind of capacity when you are looking to leaders to take on these challenges.

Chairman WARNER. I have got a couple more questions, but I will hold on them and let Senator Johnson and Conrad.

Senator Johnson.

Senator JOHNSON. Thank you, Mr. Chairman.

Mr. Podesta and Mr. Shea, thanks for testifying here.

You started mentioning a little bit in terms of the private sector. Isn't that to a certain extent the root cause of the problem? Business has a profit motive for being efficient. There is no motive in Government to be efficient. In fact, the motive for Government is to grow. So I guess one of the points I would make, I would just like to hear your comment on it. In budget cutting, that does provide some motive for becoming more efficient, and I guess I would start there, you know, actually provide a motive by reducing people's budget to get efficient. I would just like your comment.

Mr. SHEA. Well, I mean, Government does not have the profit motive, clearly. I would quibble with you a bit, with great respect, that they do not have other incentives to deliver efficiently and effectively. The public service mission is what drives many people to serve in Government, and so long as we can clearly articulate what outcome it is we are trying to achieve, I think you can get an organization to be incented to achieve that at the lowest possible cost.

Now, budget cutting, if you want to incent an agency, the threat of a budget cut is a very powerful incentive if directed correctly. Across-the-board cuts probably not the best way to ensure we are investing our money for the most effective use. But it nonetheless, can be marshaled to great effect.

Mr. PODESTA. I agree with Mr. Shea in his comments, and I think that the real question is how do you enhance the productivity to deliver better results. And I think people in public service are motivated to do that, to serve the mission of their agencies. First, there needs to be clarity about what that mission is at the agency level and the program level. And then I think Senator Whitehouse in the earlier session with Mr. Dodaro raised the question of whether rewards for actually providing those efficiencies could not be built into the budget process. I think that is something that ought to be at least experimented with or explored.

The President in his budget has put forward some ideas around using these so-called social impact bonds or pay-for success bonds which have, again, been experimented with in other jurisdictions, both here in the United States and overseas, in which payment is based on actual performance in the field, and if you enhance your performance, you get a better payment. And I think those kinds of mechanisms that give people the incentive to produce stronger results and link those to agency performance are things that the Committee I think could encourage and encourage the administration to do more of.

Senator JOHNSON. Generally, I like to seek out root causes. Would another possible root cause be Congress and this administration passing legislation that are thousands of pages long and asking for additional rules to be written, legislating through regulation? And to what extent does that make it pretty difficult for agencies to become effective?

Mr. PODESTA. Well, you know, Senator, I think that we live in a very complex state and a complex state of regulation, and I think that there is real value in trying to weed out ineffective regulation, as there is value in trying to weed out ineffective spending at a Federal governmental level.

But, you know, you can go too far. You can imagine—I think that no one would look back at what happened in advance of the financial crisis and say that we were overregulating. It seems to me that the regulators took their eye off the ball. It led to a tremendous recession in this country and pain that is still going on in communities across the country.

So I think the same disciplines that need to be applied to Federal spending ought to be applied in the regulatory mode, which is to try to get more effectiveness, more productivity, try to get the best results for the lowest cost to the private sector.

Mr. SHEA. I mean, the bottom line is yes. If you imagine reading a law and then understanding that the bureaucracy is going to take and interpret that law, the chances that what is written and what comes out of the implementation process are similar is almost by chance.

I will tout one of the products that the Center for American Progress produced, which provides a list of questions one should ask before creating a new program. The first thing you need to remember is that there is no problem in America for which we do not have a number of programs already in existence focused on that problem. But the tool that the center developed goes through a logical process of establishing the goals for the program, whether or not it will duplicate existing programs, whether the intervention identified in the new program has evidence of effectiveness already in place so that we have some expectation that it will produce results.

And I think it goes back to your point, Senator Warner, about what process can we establish before creating programs to ensure that they have a greater chance of success out of the starting gate.

Senator JOHNSON. Thank you.

Mr. SHEA. You are welcome.

Chairman WARNER. I would, before moving to Senator Conrad, just say I do think there is an opportunity for regulatory reform, and we have been working on our regulatory PAYGO idea. One of the things that has been amazing to me up here is the number of times when you come out with a clear rule, oftentimes industry then comes in with the idea of, well, under the guise of innovation we need this exception or that exception to the rule, and that is one of the things that ends up creating this kind of bureaucratic nightmare.

Let me, before I turn over the questioning to Senator Conrad, again publicly thank him for entrusting me with this responsibility 2 years ago to look at this subject area. No one in the Senate has been a clearer voice for Government efficiency and the concerns around the deficit and the debt than Kent Conrad, and I appreciate him giving us this chance, and I look forward to his questions.

Chairman CONRAD. Well, thank you, Senator Warner, and I want to thank you for the leadership that you have demonstrated and that this Subcommittee has demonstrated in exploring this whole notion of how do we get the Government to perform better. I think Senator Johnson asked some worthwhile questions, the kind of questions I get when I go home and talk to people.

You know, Government is deeply challenged when it comes to doing things in the most efficient way because the reality is there

are competing visions of what needs to be produced. And those competing visions create conflicts, and where there is conflict, there is additional complexity. And one of the jobs we have—and I think increasingly it is going to fall to the Budget Committee—is to help agencies separate the wheat from the chaff and to cut through the haze that is out there and determine what is the mission and how is it going to be accomplished and by what metrics are we going to measure whether or not the performance is what we expect.

You know, I used to be the tax commissioner of my State, elected tax commissioner, and one year I convinced the legislature to give me an additional $1 million to audit companies that were doing business in the State of North Dakota. $1 million does not sound like much money in this town, but in North Dakota in our legislature, it was a lot of money. And the commitment I made was that I believed I could raise $10 million with that $1 million. And I will tell you, they held me to account. Every quarter I was called in for 2 years and had to go through a detailed report of what I was doing with the money and what results I was getting.

That rarely happens around here. One of the reasons it rarely happens is the press of the business of the year that you are in. And it is one reason I have been persuaded to now support a biennial budgeting process so that we do budgets for 2 years—that is all we are doing, anyway. I mean, the only time we have had a budget in an election year was the last time I was able to get one in 2008. Other than that, we do not do them in an election year.

So let us recognize the reality, do 2-year budgets in the off year, spend the other year holding agencies to account. What is it that you were given the money—and I like very much the idea of tying budgets to performance. What is it that we expect you to accomplish? What are the goals and what are the metrics that we are going to apply to determine whether you are getting results?

Now, you know, there are places where that is very difficult to do, probably nowhere more difficult than the Department of Defense. But I can tell you, after serving on the President's Fiscal Commission and having the testimony that 51 percent of all Federal employees are at the Department of Defense—and that does not count the contractors. And when I asked them, "How many contractors have you got?" they said, "We cannot tell you." And I thought, you know, maybe it is a security matter. No. "We just cannot tell you. We do not know." I said, "Well, give me a range?" They told me 1 to 9 million. This is the testimony of the best defense analysts that we have got 1 to 9 million contractors at the Department of Defense, and they cannot tell you whether it is closer to 1 million or closer to 9 million.

I mean, Mr. Johnson, you are in the business world. I bet you did not run your business and not know how many contractors you had or what contracts you had outstanding or for what amounts or what the purposes of those contracts were. And I do not want to single out the Department of Defense because we have got lots of other management areas. I go to the Department of Education, and I am a very strong support of education. But the duplication there is really daunting.

You know, is it possible that some of this duplication is merited? Well, perhaps it is. But, you know, I will bet a lot of money some of this duplication is absolutely wasted.

One of the questions I have always wanted time to explore is we put money into a program to deliver certain results out the other end. We spend very little time connecting the dots. We put the money in. What comes out the other end? How much of it actually gets out to the places where it is intended? How much gets absorbed in the bureaucracy on the way?

One reason that I got very interested in this was during the flood disasters in North Dakota we looked at what other States had done, and what we found was States like to have the money sent to them, and then they distribute it to the impacted area. And one reason they like to do it is they take what they call a haircut, and the haircut can be as much as 15 or 18 percent. Well, wait a minute. What sense does that make? When we had our big disasters, we insisted the money go right to the communities of need and not go through the State for their haircut. And I think we saved a lot of Federal taxpayer dollars by doing it.

Let me just go quickly to my question, and that is, what do you see as the biggest targets of opportunity? Both of you are deeply experienced in the Federal Government. Mr. Podesta, in your experience what are the key targets of opportunity for improvement in performance?

Mr. PODESTA. Well, Senator, I think that you have highlighted a couple of them. One is duplication and elimination of duplication to try to put dollars to more effective uses and increase the return that you get on the investment.

I would say—and I will come back to it—I think that in the arena of health care there is tremendous savings that still can be done by changing delivery models, changing pricing systems, paying for performance, if you will, and producing better results at the end of the day by stopping hospital readmissions, looking at the kinds of things that I think are embedded in the new authorities that exist in the U.S. Department of Health and Human Services (HHS).

Again, Medicare, Medicaid, that is where the money is now in the Federal budget. That is where we are going up. So if we cannot get higher levels of performance for the dollars being spent there, the rest of what we are talking about is kind of swamped. But I think there is probably no agency that cannot be held to that discipline.

If I could, I would just put in one pitch for transparency. I think to the extent that the model just simply is not the Congress overseeing the Federal Government and its results that it is producing for dollars, but the American public having the capacity to oversee some of those results, we are going to be better off. And I think the experiments with Recovery.gov, with Data.gov, putting information out—I mentioned the website we put up—in terms of return on investment for public education dollars spent, both at the Federal and State level so that you can go to two similar school districts in Wisconsin, one spending $50 million more than the other and producing the same results, and begin to ask the question, Well, why is that? And I think empowering citizens with the tools

to be their own, if you will, GAO and Inspectors General to demand higher performance will do what you saw in North Dakota, Senator, which is that people will come in demanding quarterly results or maybe annual results and higher performance out of all levels of Government.

Mr. SHEA. Senator, I agree with what John said. I am not optimistic that you will be able to combine or reorganize the Government to consolidate a lot of these duplicative areas. But what you find is that often, though they have the same purpose, they are working against each other. Food safety is a perfect example where you have two agencies in the same plant, and when an incident occurs, the agency that takes over depends on the product causing the incident. They shut out the other agency so they do not get the benefit of what that other agency is learning to enhance food safety.

So the best opportunity, it would seem to me, is to ensure that, though this duplication exists, these programs are collaborating better to achieve a common outcome. And I am not aware that is happening to a great degree in any of the areas inventoried by GAO.

Chairman CONRAD. And I would just say my vote for the biggest target of opportunity would be Medicare. Ten percent of beneficiaries use 50 percent of the money. Half the budget, 10 percent of the beneficiaries. And I have always been persuaded that we ought to focus on that like a laser because what we would find, I think, is tremendous duplication of testing, tremendous overutilization of prescription drugs causing adverse drug interaction as a result, causing hospitalization. One of the biggest causes of hospitalization is adverse drug interaction.

I think there is huge savings to be garnered there, and as we go forward, I want to put a laser-like focus on that statistic.

Mr. PODESTA. Senator, you raised the Defense Department also, and we have spent a lot of time and attention on the procurement side and the system side of things that do not work and ways to produce value for lower costs. But health care in the DOD, as Secretary Gates testified yesterday, is an increasing problem. It is now over 10 percent of the base budget. It is in real—I know it is politically sensitive, but it is in real need of reform, and we have thrown some ideas out on how TRICARE could be reformed as well.

Mr. SHEA. I am probably treading in an area you know a lot more about than I do, but as you know, the Government makes more than $125 billion annually in improper payments, so each agency is working diligently to solve that problem. They all have different methods for verifying the eligibility of their recipients, and they all often establish their own sources of data to verify that eligibility. We could do a better job of creating a single or at least a set of common data elements that agencies can use to verify eligibility, and then give them access to sources of data that they should all have access to.

Chairman WARNER. Thank you, Mr. Chairman.

I will just add one last question, and that is—and then we will go to Senator Johnson if he has got a second round. A lot of the things that were talked about in Medicare—and there are good things and bad things in the Affordable Care Act. But in a lot of

these areas, we did not have the data before. Eligibility is one area we have had some, but in terms of health care outcomes, in terms of readmission rates, in terms of data that exists, the marketplace has but we do not have, is the payer, and that is one area that I think there would be concurrence across the aisle that we need to drill down on.

I guess I would just like—staying in that back-office operation area—to get your comment as well. The other piece of this—and I think, John, you made a very good point. You know, we have got to limit every agency down to—and maybe five is even too many. We tried to put three to five goals, but key goals, and one of those goals needs to be the operational piece—your procurement, your HR, your technology. I think as well we are going to have an opportunity with the retirement of the baby-boom generation to rethink and perhaps collapse some of these layers of management.

I would like to get from both of you any comments on how we can do a better job of squeezing more productivity out of the operational end. Let me just caveat on the front end, and then I will listen to—this is easier said than done. We did it in Virginia in terms of procurement and made great progress. We did it in technology. It made a logical process, but, boy, oh, boy, the implementation was a rough road. So if you have got some guidance on the back office pieces, I would love to hear it.

Mr. PODESTA. Well, I would say, you know, again, we have identified a couple places. One is in the procurement of goods and services and, you know, we will provide the Committee with our ideas on how one can consolidate that, use better business practices, and save a good deal of money there.

The other one that I think we focused on is information technology, and there is tremendous savings, I think, across the platform of the Federal Government to go to cloud computing, to be more effective in implementing systems. This administration spent a good deal of attention on trying to look at systems that were over budget and over time and tried to eliminate those. Some of these procurement projects get completely out of control. They are never cut off. The VA is probably a pretty good example of a place that has kind of gotten its act together on this.

But if you move towards—and I understand the needs for data security, et cetera. If you move to a cloud computing platform across the Government, you know, again, we estimated you could save up to $16 billion a year just in the IT side of the budget. And, you know, that is real money when you are talking about the difference between—in this fiscal year where, you know, Democrats and Republicans are in trying to close that budget gap, $16 billion is a lot of money.

Mr. SHEA. In each of these areas, procurement, human capital, IT, financial management, we have got a body of laws and regulations that have been established over time. Our firm offers process improvement services, and if we did a process improvement engagement, we would have to conclude that somebody on crack designed the Government's management processes. So I think it could stand a real fresh look at whether or not all of these laws and regulations are absolutely necessary to do what needs to be done and protect the taxpayer. I understand that a lot of these have been es-

tablished to ensure wrongdoing of the past does not recur. But I do think each of these areas could use a real spring cleaning.

Chairman WARNER. Well, at least we now have the headline for the hearing: "Shea Calls Government on Crack."

I would also add one other thing on the IT side as somebody who has wrestled through this and had a background there. It is easier to get Democrats and Republicans to agree than it is to get IT guys to agree on a common platform.

Senator Johnson.

Senator JOHNSON. Just one final comment, and honestly, I was going to also talk about the operational savings aspect in terms of a goal. But I guess I would argue that rather than just have that as a mission statement goal, the way you actually squeeze operational savings out is you put budgetary pressure on an agency. And, you know, cuts is certainly one way of doing that. The way you budget also can help out. And I guess I would like just a quick comment on zero-based budgeting versus our what I think is a pretty wacky way of baseline budgeting.

Mr. SHEA. I think the principles of zero-based budgeting ought to be brought to bear on the Federal Government; that is, let us ensure that we have adequate justification for every dollar we are spending. You know, I think the review is that the GPRA Modernization Act provide a good basis for making that judgment. How well are our programs working? And what can we eliminate? What is worthy of additional investment? So, I mean, I think that is an excellent base from which to start having the conversation.

Mr. PODESTA. I agree with that, Senator, and I would just note that what we have now really is a budget process and a performance process, and they have to be linked. No business would budget without regard to what the outcomes and the performance of that budget was likely to produce. No think tank would do it. No consulting firm would do it. It just would not happen. And yet that is essentially what we have. We have budget decisions being made that are highly disconnected from the performance that is the result of the GPRA Modernization project, and I think that one of the key goals of the Chief Operations Officer in these agencies, the Deputy Secretaries in these agencies, is to link those efforts so that budget follows performance and that people are rewarded for producing better results.

Senator JOHNSON. I just want to say thank you, Mr. Podesta and Mr. Shea and Mr. Chairman.

Chairman WARNER. Thank you, Senator Johnson, and I really appreciate your participation and active participation. I think we have got another member of the management caucus here, and let me thank you both. And let me just again close with where we started.

I think this GPRA Modernization Act may be the smallest little bill that nobody has heard of that could actually have long-lasting effects as we grapple with the enormous challenges around the deficit and will give us some of these tools. And I would simply invite both of our witnesses today to stay on us to make sure that this bill gets appropriately implemented and that we from our oversight responsibility make sure that we keep the administration's feet to the fire. They have talked about a lot of good things. I think they

have started some good initiatives. But we have got to make sure they follow them through.

With that, if there are no further questions, the hearing will be closed.

[Whereupon, at 12:02 p.m., the Committee was adjourned.]

Response Provided for the Record by

Gene L. Dodaro, Comptroller General of the United States

Senate Budget Committee Hearing

"Modernizing Performance: Using the New Framework"

March 16, 2011

How pervasive are mission statements in federal agencies? Do mission statements define the mission of a particular agency effectively?

The Government Performance and Results Act (GPRA) of 1993[1] requires agencies to develop strategic plans that contain "a comprehensive mission statement covering the major functions and operations of the agency." Our work on GPRA implementation during the past two decades has generally shown that agencies have included mission statements in their strategic plans. For example, in 1997 we reviewed the draft strategic plans of 27 cabinet departments and selected independent agencies and found that all 27 of the draft plans included a mission statement.[2] Subsequently, in a 2004 review we found that the strategic plans we reviewed for six selected agencies contained mission statements that generally met standards for being results-oriented, distinct from other agencies, and covering the agencies' major activities.[3]

[1] Pub. L. No. 103-62, 107 Stat. 285 (1993).

[2] GAO, *Managing for Results: Critical Issues for Improving Federal Agencies' Strategic Plans*, GAO/GGD-97-180 (Washington, D.C.: Sept. 16, 1997).

[3] GAO, *Results-Oriented Government: GPRA Has Established a Solid Foundation for Achieving Greater Results*, GAO-04-38 (Washington, D.C.: Mar. 10, 2004).

Response Provided for the Record by
Gene L. Dodaro, Comptroller General of the United States
Senate Budget Committee Hearing
"Modernizing Performance: Using the New Framework"
March 16, 2011

In its past work, has GAO identified programs or pilots, at the federal or state government levels, that try to create positive reinforcement mechanisms for agencies or employees to identify potential efficiencies or savings and act upon them?

Yes, GAO has conducted work that identified federal government programs and pilots that provided incentives to improve productivity and reduce costs. We issued several reports in the 1980s and 1990s that focused on such programs. Although these reports go back several decades, the insights they provide into the use of incentive programs in the federal government may still be relevant today.

- In 1980, we reported that productivity-based reward systems in several agencies had positive effects in certain work situations, and that there was potential for greater use of the concept in the federal government.[1] However, we found that the characteristics and design of these systems differed greatly, and that some agencies had not incorporated key features, such as developing performance standards for productivity. Our work identified four general principles for agencies to consider when developing reward systems. These principles are (1) judging performance on objective and measurable production standards, (2) offering rewards of value to employees, (3) ensuring employees understand the connection between production standards and rewards, and (4) ensuring the system is accepted by employees and fairly implemented by management. Our report also outlined key information that the Office of Personnel Management (OPM) could include in guidance to agencies on productivity-based rewards systems, including information on the appropriateness of reward systems, developing standards of productive performance,

[1] GAO, Ways to Improve Federal Management and Use of Productivity Based Reward Systems, GAO/FPCD-81-24 (Washington, D.C.: Dec. 31, 1980).

designing reward schedules, controlling other factors and behaviors, and implementing and managing reward systems.

- The Department of Defense (DOD) began experimenting with gainsharing[2] in the late 1970s and we reported on 18 DOD gainsharing efforts in September 1986.[3] We found that each effort reported cost savings ranging from several thousand to over a million dollars. For example, the Sacramento Air Logistics Center initiated a gainsharing program for its data transcription unit in September 1982, and by December 1985, the program had achieved about $252,000 in cost savings, which were shared 80/20 percent between the government and the employees, respectively. In addition, several efforts tracked and reported on indirect benefits, such as decreased sick leave usage and reductions in work backlogs and overtime costs. However, we also reported on barriers identified by DOD officials to implementing gainsharing programs. For example, DOD officials stated that they believed a lack of specific legislation authorizing gainsharing programs in the federal government made agency managers hesitant to develop such programs. In addition, at the time of our review, OPM had not published any guidance for federal agencies interested in establishing gainsharing programs, and DOD officials stated that OPM's existing guidance for incentive programs provided limited flexibility in designing and operating gainsharing efforts.
- In 1987, we reported on a survey that we conducted to develop an inventory of innovative human resource management practices in 71 federal organizations, covering about 92 percent of the executive branch's full-time, permanent civilian work force.[4] Agencies reported using a wide variety of practices, including several aimed at improving organizational effectiveness and employee performance/utilization. For example, 52 agencies reported undertaking organization downsizing to eliminate duplicative services and activities. At the individual employee level, 46 agencies reported using incentive

[2] In this report, we defined gainsharing programs as incentive systems that measure gains in employee productivity and share the savings generated between employees and the organization.

[3] GAO, *Gainsharing: DOD Efforts Highlight an Effective Tool for Enhancing Federal Productivity*, GAO/GGD-86-143BR (Washington, D.C.: Sept. 26, 1986).

[4] GAO, *Human Resource Management: Status of Agency Practices for Improving Federal Productivity*, GAO/GGD-87-61FS (Washington, D.C.: June 16, 1987).

programs to recognize high performance and achieving efficiencies in work operations. To illustrate both of these practices, in 1985, the Air Force Commissary Service (the Service) consolidated 16 complexes into 8 regions to increase managerial effectiveness, streamline operations, improve patron service, and better utilize employees. It carried out the downsizing while minimizing the adverse impact on employees. Employees were individually counseled and reassigned, and no jobs were downgraded. The Service also introduced a program, the "Excellent Commissary Service," to eliminate impediments to efficiency and to encourage employee contributions. Managers were given greater authority to introduce their own initiatives to improve efficiency and customer service, and employees were encouraged to make a conscious effort to improve their stores and to consider no problem unsolvable. The Service reported several positive benefits from both programs, including greater upward mobility, motivation, innovation, and employee self-fulfillment.

- In a 1995 report on Quality Management (QM)—a management approach that emphasizes improving product quality while decreasing production costs by increasing the efficiency of work processes—we described the human resource management practices used to implement QM by 10 federal organizations that won awards for the advanced level of their initiatives.[5] One of the organizations featured in this report was the Naval Aviation Depot at Cherry Point, NC, which instituted the first activity-wide productivity gainsharing program in the federal government. We reported that the program provided monetary rewards to all qualified civilian employees when the depot exceeded the productivity levels based on improvement over a historical baseline. To ensure that employees understood the team concept and how their efforts translated into awards, the depot provided training to all employees on gainsharing. Similarly, the depot's total line item that was budgeted for quality step increases and achievement awards were shared equally by all civilian employees whose performance under the performance appraisal review system was deemed satisfactory.

[5] GAO, *Federal Quality Management: Strategies for Involving Employees*, GAO/GGD-95-79 (Washington, D.C.: Apr. 18, 1995).

- The major management reform initiative during the Clinton Administration—NPR, which began in 1993 as the National Performance Review and subsequently became known as the National Partnership for Reinventing Government—was intended to identify ways to make government work better and cost less. During the 1990s and in 2000, we issued several reports monitoring implementation of the recommendations that stemmed from NPR.[6] A few of the governmentwide recommendations focused on providing federal employees with incentives, such as allowing agencies to develop their own performance management systems that could include incentives. However, our work found that these recommendations were not fully implemented, although some actions were taken related to them. For example, responsibility for helping agencies implement gainsharing initiatives was assigned to the Federal Quality Institute (FQI). At the time of our last review of this specific recommendation, FQI had not begun work related to gainsharing.

Our recent work on efficiency measures could provide insight for needed improvements in this area. The President's Management Agenda (PMA)[7] and Program Assessment Rating Tool (PART)[8] initiatives of the previous presidential administration emphasized improving government efficiency with specific requirements for agencies to develop program-level efficiency measures and show annual improvements in efficiency. In a 2010 report, we reviewed efficiency measures agencies developed for the PART process.[9] Of the efficiency measures we

[6] For example, see GAO, *Management Reform: Implementation of the National Performance Review's Recommendations*, GAO/OCG-95-1 (Washington, D.C.: Dec. 5, 1994); *Management Reform: Completion Status of Agency Actions Under the National Performance Review*, GAO/GGD-96-94 (Washington, D.C.: June 12, 1996); and *Reinventing Government: Status of NPR Recommendations at 10 Federal Agencies*, GAO/GGD-00-145 (Washington, D.C.: Sept. 21, 2000).

[7] The PMA, which was first announced in 2001, consisted of five governmentwide management priorities, including budget and performance integration, strategic management of human capital, expanded electronic government, improved financial performance, and competitive sourcing.

[8] OMB described PART, which was created in 2002, as a diagnostic tool meant to provide a consistent approach to evaluating federal programs as part of the executive budget formulation process.

[9] GAO, *Streamlining Government: Opportunities Exist to Strengthen OMB's Approach to Improving Efficiency*, GAO-10-394 (Washington, D.C.: May 7, 2010).

reviewed, a similar number reported efficiency gains and losses.[10] Officials for some programs stated that the efficiency measures reported for PART were useful, and described ways in which they used the data, such as to evaluate proposals from field units, lower the cost of a contract, or make decisions to shift production. We also identified a broader array of strategies for achieving efficiencies, such as governmentwide reviews, agency restructurings, process and technology improvements, and strategic spending approaches. In addition, we reported that the Government Performance and Results Act of 1993 (GPRA)[11]—which Congress enacted in part to improve federal program effectiveness and accountability, enhance congressional decision making, and address waste and inefficiency in federal programs—provides a framework for planning future efficiency gains while maintaining or improving effectiveness and quality of outputs or outcomes. The Office of Management and Budget (OMB), as the focal point for management in the executive branch, provides guidance and supports information-sharing mechanisms, such as the Performance Improvement Council, which could also be used to create a more strategic and crosscutting focus on agency efforts to improve efficiency. At the time, OMB had not clearly indicated whether programs should continue measuring efficiency nor had it emphasized efficiency in its GPRA guidance to agencies. Based on our findings, we recommended that OMB evolve from an approach that primarily relied on measuring efficiency at the program level, to a broader approach that emphasizes establishing efficiency goals and identifying and pursuing strategies and opportunities to improve efficiency at each of the governmentwide, agency, and program levels.

Furthermore, because the focus of the Committee's hearing was on the GPRA Modernization Act of 2010,[12] it is worth noting that the act requires agencies to establish a balanced set of performance measures, including, as appropriate, efficiency measures. Congressional use of agency goals and measured results—including those related to efficiency—in its decision making will send an unmistakable message to agencies that Congress considers agency

[10] In our 2010 report, we noted that an improvement in efficiency can be achieved by maintaining quantity or quality of outputs or outcomes while reducing costs, as well as, by improving the quantity or quality of outputs or outcomes while maintaining (or reducing) costs. Thus an improvement in efficiency need not involve a reduction of costs.

[11] Pub. L. No. 103-62, 107 Stat. 285 (1993).

[12] Pub. L. No. 111-352, 124 Stat. 3866 (2011).

performance a priority. Congressional oversight and sustained attention by top administration officials can also provide strong incentives for further improvement in the performance and efficiency of federal programs and operations.

POLICY PRESCRIPTIONS FOR THE ECONOMY

THURSDAY, SEPTEMBER 15, 2011

COMMITTEE ON THE BUDGET,
U.S. SENATE,
Washington, DC.

The Committee met, pursuant to notice, at 9:30 a.m., in Room SD–608, Dirksen Senate Office Building, Hon. Kent Conrad, Chairman of the Committee, presiding.

Present: Senators Conrad, Wyden, Nelson, Whitehouse, Warner, Merkley, Begich, Coons, Sessions, Johnson, and Ayotte.

Staff Present: Mary Ann Naylor, Majority Staff Director; and Marcus Peacock, Minority Staff Director.

OPENING STATEMENT OF CHAIRMAN CONRAD

Chairman CONRAD. The hearing will come to order. I want to welcome the witnesses today before the Senate Budget Committee. This is really an outstanding group of economists, all of them with high credibility and all of them people who have testified before this Committee on many occasions, and we very much appreciate your willingness to come back at this important moment.

Today we will focus on the economy and additional steps that could be taken to strengthen our economy. We are fortunate to have three outstanding witnesses:

Dr. Mark Zandi, chief economist at Moody's Analytics. Dr. Zandi has been very helpful to this Committee and has testified here several times, as I mentioned before. We are grateful that he could be here again today.

Dr. Chad Stone, chief economist at the Center on Budget and Policy Priorities. Dr. Stone was the chief economist here at the Budget Committee in 2001 and 2002. We are delighted to have him back.

Dr. Kevin Hassett, the senior fellow and director of the American Enterprise Institute for Public Policy Research. Dr. Hassett last appeared before our Committee as a witness in 2006, and we are very pleased to have him back as well.

I want to begin by providing an overview of our economic situation, at least from my perspective. It is important to remember just a few years ago we were in the midst of a financial crisis and severe recession, the worst recession since the Great Depression. The Federal response to that crisis I believe helped us pull back from the brink and helped put us on the road to recovery. But that recovery has now slowed and may be faltering, and we face a very real threat of slipping back into recession. That is the fundamental

reason for this hearing. I believe it is imperative that we look at all of our options going forward.

Let me just review what has happened to economic growth. In the fourth quarter of 2008, the economy contracted at a rate of 8.9 percent. Positive economic growth returned in the third quarter of 2009, and we now have had eight consecutive quarters of growth, but growth has clearly slowed this year to only four-tenths of 1 percent in the first quarter and 1 percent in the second quarter.

Private sector job growth has followed a similar pattern. In January of 2009, the economy was losing more than 800,000 private sector jobs a month. Private sector job growth returned in March of 2010, and we have now had 18 consecutive months of growth. However, in August we gained only 17,000 private sector jobs, which is clearly far below what is needed. We have to do better. And the unemployment rate remains stubbornly high. As of August, the unemployment rate was 9.1 percent.

We know that some of the drag holding back recovery is caused by the nature of the recession that preceded it. Economists have found that, following recessions that were caused by or accompanied by a severe financial crisis, recoveries tend to be shallower and take much longer to recover from.

Here is what two leading economists, Dr. Carmen Reinhart and Dr. Vincent Reinhart, found in their research. They wrote, and I quote: "Real per capita GDP growth rates are significantly lower during the decade following severe financial crises. In the 10-year window following severe financial crises, unemployment rates are significantly higher than in the decade that preceded the crisis. The decade of relative prosperity prior to the fall was importantly fueled by an expansion in credit and rising leverage that spans about 10 years. It is followed by a lengthy period of retrenchment that most often only begins after the crisis and lasts almost as long as the credit surge."

In other words, we could see an extended period of low growth and relatively high unemployment due to the fact that we are recovering from a severe financial crisis.

At the time forecasts were made that we would have an 8-percent unemployment rate following this financial crisis. I said at the time I did not believe that forecast, and I did not believe it because it was based on a recovery from the previous nine recessions. And this is not a recession or a downturn that can be compared to the previous recoveries from the nine earlier recessions. And why not? Because huge damage was done to the financial sector, and I am pleased to see that the research done by the two Reinharts really confirms that view, that after a severe financial crisis the downturn is much longer and more severe.

We also know the Federal response to the recession and financial crisis—and I say this as my view—helped to pull the economy back from the brink and made the recovery stronger than it would have been without it. One of our witnesses here today, Dr. Zandi, along with Dr. Alan Blinder, former Vice Chairman of the Federal Reserve, completed a study last year that measured the impact of Federal actions to shore up the economy, including both the Fed's monetary policy actions and the fiscal policy actions taken by Congress and the administration. Here is a quote from that report: "We

find that its effects"—talking about the Federal response to the downturn—"on real GDP, jobs, and inflation are huge and probably averted what could have been called 'Great Depression 2.0.' When all is said and done, the financial and fiscal policies will have cost taxpayers a substantial sum, but not nearly as much as most had feared and not nearly as much as if policymakers had not acted at all. If the comprehensive policy responses saved the economy from another depression, as we estimate, they were well worth their cost."

I would welcome any further comment from Dr. Zandi in his testimony on this point.

This chart shows Dr. Zandi and Dr. Blinder's estimate of the number of jobs we would have had without the Federal response. It shows we would have had 8.1 million fewer jobs in the second quarter of 2010 if we had not had the Federal response. And by "the Federal response," I am talking about TARP, I am talking about stimulus, the combination of those Federal responses.

We see a similar picture in the unemployment rate. If we had not had the Federal response, the unemployment rate would have been 15 percent, according to their analysis, in the second quarter of 2010 and would have continued rising to 16.2 percent in the fourth quarter of 2010.

Looking forward, it is clear—again, I say this as my view. The great thing about our country is we have diverse views, and we will see them expressed here today no doubt. This is my view: I believe we need a two-tracked approach which policies geared to increase short-term economic growth and job creation, coupled with policies to reduce long-term debt. I think many know I have felt very strongly about the debt threat for many years. Judd Gregg and I, when he was the Ranking Member, proposed 5 years a commission to deal with the looming debt threat. I believe that with every fiber in our being that this debt threat constitutes a serious matter for the country going forward, but I also recognize we are in a period of continuing weakness, and the really tough steps that need to be taken need to be carefully timed.

Here is what CBO Director Elmendorf said about such a two-tracked approach in his testimony this week before the Select Committee on Deficit Reduction, and I quote Dr. Elmendorf: "There is no inherent contradiction between using fiscal policy to support the economy today, while the unemployment rate is high and many factories and offices are underused, and imposing fiscal restraint several years from now, when output and employment will probably be close to their potential. If policymakers wanted to achieve both a short-term economic boost and longer-term fiscal sustainability, the combination of policies that would be most effective, according to our analysis, would be changes in taxes and spending that would widen the deficit today but narrow it later in the decade." I believe Dr. Elmendorf has that right.

The Obama administration has now proposed legislation designed to spur near-term growth and job creation. Here are key provisions in the President's Jobs Act: one, it would cut payroll taxes for employees and employers; two, it would provide a tax cut for businesses to encourage growth and hiring; three, it would provide for investments in infrastructure, including roads, rail, air-

ports, and schools; it would provide funding for States to prevent layoffs of teachers, police, firefighters; and it would help provide for the long-term unemployed. That is to all be done in the context of an overall plan to reduce deficits and debt over the next 10 years in a significant way.

I hope our witnesses will comment on the merits of these proposals from their perspective and let us know if there are other policies Congress should be considering.

With that, I will turn to my excellent Ranking Member, Senator Sessions, for his opening remarks, and then we will turn to our witnesses for their testimony. Senator Sessions.

OPENING STATEMENT OF SENATOR SESSIONS

Senator SESSIONS. Thank you, Mr. Chairman, for hosting the hearing today, and thanks to Dr. Zandi, Dr. Stone, and Dr. Hassett. We are delighted to have you join us, and I am sure we will have a good discussion today.

I do wish that we had had a hearing sooner. It has been 182 days since our Committee has held any hearing and 869 days, I hate to say, since the Democratic Senate has adopted a budget. Majority Leader Reid said it would be foolish to adopt a budget not too long ago. The fact that our Nation continues to operate without a budget I think does lie at the heart of one of the problems of our economic situation. America desperately needs the confidence and predictability that only a concrete fiscal plan can provide. The budget process I do not think is broken. It has been abandoned.

And I think President Obama must share responsibility for our failure. He consistently has refused to put forward a serious long-term fiscal plan on paper that can withstand scrutiny. Since taking office, the debt has surged nearly $5 trillion. During that time unemployment has remained above 8 percent every single month. Growth has now stagnated. We are very concerned about the economy at this state, and some are saying we have a 30- to even 50-percent chance of a double-dip recession, and we certainly hope that does not occur.

So now in the grips of crisis, we are told the President has a new plan to revive the economy. We received a proposal on Monday, with no fiscal details, that just offers more of the same. It calls for a sudden increase in the deficit, $450 billion, with a promise to pay for it at some later date through higher tax increases. In other words, more spending, more taxing, more borrowing, more debt.

President Obama still does not get it. I am convinced—and this is my personal view—that the debt is already destroying jobs right now; that the debt itself could be part of why we are missing the projections of growth that so many have made. And increasing the debt only digs us into a deeper hole, harder to get out.

We may have raised our legal debt limit recently, but we perhaps have breached our economic spending limit. America's $14.5 trillion gross debt is now 100 percent of GDP. A prominent study from the economists Rogoff and Reinhart that you noted, praised by Secretary Geithner as an excellent study, shows that when a Nation's gross debt reaches 90 percent of GDP, it loses on average a percentage point or more in economic growth each year.

So it would appear to me, in my personal view, that the debt itself may be depressing growth right now, and this might be one of the explanations for the disappointing performance in recent weeks.

Keynesian elites in Washington continue to insist what common sense denies. They tell us that even more spending and more borrowing is the answer. But when you have reached 100 percent of GDP, to try this failed experiment yet again is to put us at risk. We definitely need to be careful about this prospect.

We have seen where this road leads. I am afraid it leads to Greece. It leads to certain economic crises, as the Fiscal Commission Chairmen Bowles and Simpson told us in this Committee room. We are heading to the most predictable economic crisis the Nation has ever faced. Why? Debt. They were talking about our debt.

Why should we continue to trust, affectionately, as I call them, "masters of the universe"—maybe you three are part of that group—who tell us that we can spend and borrow our way to prosperity? Why don't we borrow twice as much? They have been wrong, it looks like, from the beginning.

In 2009 the administration claimed that the stimulus would prevent unemployment from rising above 8 percent. Mr. Chairman, I think you were warned that that may not be accurate, but that is what we were told by the official Government of the United States, the President and his team. After the bill became law, however, unemployment rose to 10 percent and remains at 9.1 percent today—a disappointing number by all accounts.

One of our witnesses today, Dr. Zandi, a very able witness, in his testimony before the Committee about a year ago said, "The next 6 to 12 months will be uncomfortable as the economy struggles to gain traction, but a full-fledged expansion should take hold by this time next year." So it is now "this time next year." That was last September, I believe, when you made that comment.

In January of this year, CBO projected economic growth for 2011—in January of this year, our CBO said growth would be 3.1 percent for the year. In February 0MB, the President's Office of Management and Budget, predicted growth would be 3.1 percent. Yet the economy experienced just four-tenths-of-1-percent growth in the first quarter, following by only 1-percent growth in the second quarter.

Indeed, Dr. Zandi, who has been one of the most prominent of spending and borrowing stimulus advocates in the economy as a way to boost the economy, and who has been a close adviser to the Democratic Senate Majority, has seen his projections prove to be dramatically inaccurate. His Moody's Analytics in January of this year—in January of this year, Moody's Analytics predicted we would have an astonishing 3.9-percent growth this year, but this month had to drastically lower that estimate to 1.6 percent.

So forgive me if these grim numbers do not give me confidence that the newly proposed stimulus plan will produce the results promised. More spending, more borrowing, and more taxing I am afraid is not the way forward. We need policies that improve conditions for job creation, that do not add to the debt.

We must produce more American energy, taking advantage of our vast untapped energy reserves. Energy policy is not simply a matter of national security. It is a matter of economic security and growth. If the Government would simply permit access to our own natural resources, we could have the kind of growth they have in North Dakota, which is helped by energy production. It would lead to the creation of millions of jobs and billions of dollars in Federal revenues and reduce the transfer of wealth that occurs when we purchase 60 percent of our oil from abroad.

We should also agree to immediately eliminate all regulations that have no real benefit but impose economic costs. There are thousands of these. Unfortunately, the administration has been going in the opposite direction. For example, in fiscal year 2010, the administration issued 66 major rules, 74 percent higher than the average number under Presidents Clinton and Bush.

Permanent structural reform of the Tax Code is another area that could spur economic growth without adding to the debt. Such reform will provide the economic certainty and predictability that is needed. But the goal of tax reform must be to increase opportunity for American workers and businesses, not bail out Washington's big spenders by hammering the American taxpayer.

In time of crisis, confusion, and fear, we should return to basic core principles, the tried and true: pay your debts, spend within your means, live according to a budget, remove the barriers of an ineffective bureaucracy, allow the private sector to flourish. If we take these steps, if we rely on the good sense and wisdom of the American people, we will see resurgence in growth, jobs, and opportunity.

There is no quick fix, no gimmick that will get us there. The road ahead is not easy, but through diligence, hard work, less welfare, more productivity, and common sense, we can put this country on a sound, prosperous path to a better future for Americans today and our children tomorrow.

I know that these reflect my views, but, you know, we are just here 1 of 100, aren't we, Senator Conrad? And we do our best. I respect your views and look forward to the discussion we will have.

Chairman CONRAD. Thank you. Thank you, Senator. We respect your views as well, and we respect the views of these witnesses and look forward to their sharing them with us.

Mr. Zandi, do you want to go first? Dr. Zandi.

STATEMENT OF MARK ZANDI, PH.D., CHIEF ECONOMIST, MOODY'S ANALYTICS

Dr. ZANDI. Sure. Thank you, Senator Conrad, Senator Sessions, and the rest of the Committee, for the opportunity to be here today. I do appreciate it.

The views I am expressing are my own, not those of the Moody's Corporation, and you should know that I am not part of the rating agency, so I have no direct impact on ratings.

I will make three points in my remarks. The first point is the economy is struggling to avoid recession. This is most obvious in the job market. You showed a nice chart with respect to job growth.

At the beginning of the year, the economy was doing quite well, creating over 200,000 jobs per month, and that is a pretty healthy

rate of growth, certainly enough to bring down the rate of unemployment. More recently growth has slowed. As you pointed out, in August we had no growth—private sector job growth, but no growth after you consider the layoffs in the Government sector, State and local.

I ascribe this to a number of reasons, the slowdown, and you are right, Senator Sessions, I was more optimistic at the beginning of the year, and I was wrong. The economy has slowed. I did not expect it. And I ascribe that to a few reasons, really just a series of unfortunate events.

First was the surge in energy prices. Four dollars for a gallon of regular unleaded is pretty tough for Americans, and that is what we were paying at the end of April, early May. There were a lot of reasons for that, but I think one of the key reasons was the unrest in the Middle East, which I do not think you can predict.

Second, the Japanese earthquake. That was very debilitating on manufacturing, and manufacturing has been a key source of growth throughout this economic recovery. In fact, half of the GDP growth in this recovery has been in manufacturing, and that was significantly disrupted by the Japanese quake effects.

But, more importantly, I would ascribe the slowdown to what I would consider some pretty egregious policy errors, both here in the U.S. and in Europe. I think the debilitating debate over the debt ceiling eviscerated confidence, and you can see that in the first slide, if you bring that forward. The first slide shows—there you go—two measures of confidence: one is the consumer confidence, this is from the University of Michigan survey; and the other is a measure of small business confidence. And you can see both are indexed to equal 100 back in 1986 to be consistent. You can see how hard confidence was hit during the recession. Some recovery or revival in confidence during the recovery, but it has been creamed in the last couple of months. And the University of Michigan survey is back to near record lows. Confidence is hammered.

European policy errors have also contributed. Obviously, they are having a great deal of difficulty, and that is reverberating back on us. The European Central Bank raised interest rates. I think that was an error. More importantly is the way the Europeans are handling the Greek debt crisis. That has significantly undermined sentiment throughout Europe, and, again, that is affecting our economy.

So households, businesses, and investors have lost faith, and that is why we are where we are. I do agree that without the policy efforts in early 2009—in late 2008 under the Bush administration and in early 2009, the economy would be in a measurably worse place today, but the policy mistakes in the last couple of months have been debilitating.

This gets to my second point, and that is, to stabilize confidence and avoid a recession, policymakers—Congress and the administration—must act decisively and definitively, have to do two things at the same time in the next few months. The first is to follow through on the debt ceiling deal. We need clear, definitive, long-term deficit reduction. Absolutely necessary. I think that is key. But, secondly, at the same time, we need to take some of the fiscal restraint that is headed our way in 2012 off the table. I did not

think that at the beginning of the year. I was all about thinking that we should focus on deficit reduction. We could digest the restraint that was coming in 2012. But I do not think that now. I think the economy is too weak to do that.

But, you know, I am encouraged by the debt ceiling process. I think it is a substantive process. I think there is general consensus that we need about $4 trillion in deficit reduction over the next 10 years to get to fiscal sustainability. And if you look at the next slide, you can see what would happen if we do not follow through on the debt ceiling deal. This shows the ratio of publicly traded Federal debt—not gross debt but publicly traded Federal debt to GDP, and you can see where history ends, and I am showing you a fair amount of history all the way back to Alexander Hamilton, which, by the way, is not an easy thing to do. You should appreciate the chart that took a fair amount of work. And in the forecast, it is pretty serious, and we do get above that 90-percent threshold that Rogoff and Reinhart have pointed to as a serious threshold if we do not make changes. So we need that deficit reduction, about $4 trillion worth.

We have made some progress, $900 billion Congress agreed to. I think that is laudable. I think the Super Committee has a fighting chance at the $1.5 trillion which they have been tasked to do. They absolutely need to do this. If they do not do this and they do not do this in a way that is not upsetting to people, we will go back into recession. I do not think this can be punted down the road. It has got to be done in the next few months because we will go into recession. Of course, if we go into recession, our fiscal problems will get measurably worse very, very quickly.

I also think that, you know, if you do the math, the arithmetic, we need more deficit reduction, but I think that can wait until after the election in the lead-up to the expiration of the Bush tax cuts in 2013. And I would say I think we need spending cuts, and the preponderance of the deficit reduction should be spending cuts. But we also need tax revenue increases, and that should come through closing of loopholes and broadening the tax base so that we do not have to raise marginal rates and even hopefully lower marginal rates for corporations. I think that is something that we need to do to improve competitiveness.

Finally, point number three is the point about coming fiscal restraint. If policymakers do nothing, if you do nothing, in 2012 Federal fiscal policy will subtract 1.7 percentage points from growth, and you can see that in the next slide, which shows the contribution of growth from different stimulus efforts. And you can see what will happen in 2012 without any additional help—1.7 percentage points. If you throw in State and local government cuts, it gets to 2 percentage points. I do not think this economy can digest that.

I think the President's proposal is a good effort. I think that if enacted in its totality and it is paid for—and I think it should be paid for—it will add about 2 percentage points to growth in 2012, fully offsetting the fiscal drag that is in train, adding 1.9 million jobs and lowering the unemployment rate by a percentage point. But, you know, there are a lot of things in the package. The one thing that is absolutely critical to do is to extend and expand the payroll tax holiday for employees. That would reduce the fiscal

drag in 2012 by half, and I think that would help. That would be very helpful to getting the economy through this period.

There are a couple of other longer-term things that are very good in the package. We need to start thinking longer run. The reforms to unemployment insurance, including work share, are an excellent idea, very important to helping the German economy through this period, and the infrastructure bank. It will not mean any jobs next year or the year after, but that is a good idea that deserves careful attention.

Let me end by saying that, you know, we need to start thinking longer-run here. Your first goal needs to be the immediate near term and making sure we do not go back into recession. But we have got a long-term problem, and so we need to start thinking about long-term economic policies, and at the very top of the list, the thing that I would focus on that is doable is corporate tax reform. We need that, and I would focus on that right away.

Thank you.

[The prepared statement of Dr. Zandi follows:]

Written Testimony of Mark Zandi
Chief Economist and Co-Founder Moody's Analytics

Before the Senate Budget Committee

"Policy Prescriptions for the Economy"

September 15, 2011

The economy is on the cusp of recession. The political fight over the debt ceiling and Standard & Poor's downgrade of U.S. Treasury debt have rattled the already-fragile collective psyche. Consumers and businesses appear frozen in place. They are not yet pulling back, but to stabilize sentiment and avoid a downturn, it is vital for policymakers to act aggressively.

There is reasonable concern that policymakers can do little to alleviate the crisis of confidence. Interest rates are already extraordinarily low, the federal government is running unprecedented deficits, and European leaders are struggling to keep the euro zone together. The will to act is also impaired by a polarization of political and economic views. A loss of faith in the political process is significantly contributing to the loss of faith in the economy.

But policymakers are not out of options. The Federal Reserve's bold announcement of its intention to keep short-term interest rates near zero until mid-2013 has brought down long-term interest rates and supported stock prices. The Fed can provide even more help by extending the maturity of its Treasury bond portfolio and purchasing more bonds in another round of quantitative easing. More QE would not be without its problems, but they would be outweighed by the positives.

EU policymakers' recent agreement to increase the flexibility of their stability fund and to help resolve troubled banks is significant. Until these new powers are up and running, the European Central Bank is once again buying sovereign bonds. The Europeans need to get ahead of worried financial markets by dramatically expanding the size of the bailout fund. This in effect would push Europe down the path to the adoption of a euro bond and fiscal integration, which is necessary to fully quell the debt crisis.

Most important, President Obama and Congress must conclude the debt-ceiling deal in a reasonably graceful way in the next few months. Another round of political vitriol will be too much for the collective psyche to bear. As part of this process, policymakers must also agree to scale back the significant fiscal restraint that is fast approaching and provide more support to the beleaguered housing market. Given the economy's current difficulties, it is hard to see how it will be able to manage through these headwinds. Tax reform is not immediately necessary, but it is key to achieving fiscal sustainability in the long term.

Another recession would be debilitating. The unemployment rate would quickly rise back into double digits and could remain there for years. Our daunting fiscal problems would become overwhelming as tax revenues fell and demands rose on government programs to help the economically hard-hit. This dark scenario can be avoided, but only if policymakers act definitively and deftly.

Recession threat

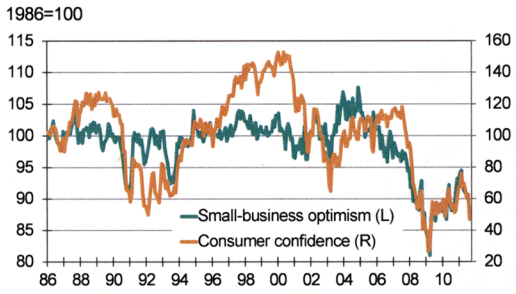
Recession risks are uncomfortably high, largely because confidence is so low. The economy continues to grapple with a number of fundamental problems, most notably the foreclosure crisis, a surfeit of homes and commercial space, and yawning government deficits. But even more serious is that investors, consumers and businesses appear shell-shocked by recent events.

Confidence normally reflects economic conditions; it does not shape them. Consumer sentiment falls when unemployment, gasoline prices or inflation rises, but this has little impact on consumer spending. Yet at times, particularly during economic turning points, cause and effect can shift. Sentiment can be so harmed that businesses, consumers and investors freeze up, turning a gloomy outlook into a self-fulfilling prophecy. This is one of those times.

The collective psyche was already very fragile coming out of the Great Recession. The loss of 8.75 million jobs and a double-digit unemployment rate have been extraordinarily difficult to bear. Businesses have also struggled with a flood of major policy initiatives from Washington, led by healthcare and financial regulatory reform. Other major policy debates, over issues such as immigration, energy and unionization, produced no legislation but still left businesses nervous.

The drama over raising the nation's debt ceiling, and especially S&P's downgrade of U.S. debt, eviscerated what confidence remained. While losing the AAA rating has little actual significance—Treasury yields have fallen since the downgrade—it apparently unnerved investors, judging by the plunge in stock prices. Consumer and small-business confidence gauges are as low as they have been outside the Great Recession (see Chart 1).[i]

Chart 1: A Very Fragile Collective Psyche



Sources: National Federation of Independent Business, Conference Board

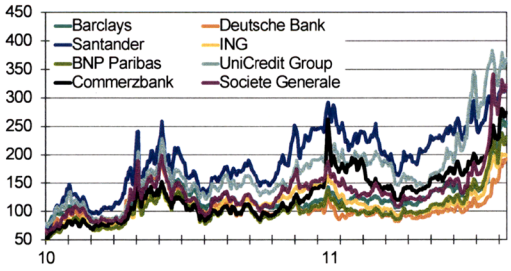
A loss of faith in the economy can quickly become self-fulfilling. A key conduit is the stock market. Since equity prices peaked in late April, some $3 trillion in wealth has evaporated. Since every $1 decline in stock wealth is estimated to reduce consumer spending by 3 cents, the loss to date means spending will take a $100 billion hit over the coming year. This in turn will reduce real GDP growth by about two-thirds of a percentage point.

Stock prices also serve as signals to businesses, letting firms know when it is time to expand as well as providing the means to do so. Rising stock prices embolden managers to take risks and seek growth opportunities, and a rising market allows firms to issue more equity to fund investment, hire, or acquire other businesses. Conversely, falling stock prices weigh heavily on those animal spirits so vital to a well-functioning economy.

A crisis of confidence can also impair the financial system. Banks and other financial institutions borrow heavily from one another to fund their activities. Much of this is overnight or short-term borrowing; thus even a brief disruption in money flows can trigger a financial crisis. While such a scenario seems unlikely at the moment, serious stress lines are developing, particularly in Europe. The Euribor interbank lending rate—the rate that European banks pay to borrow for brief periods—has more than doubled over the past several weeks. European banks also appear to be turning to the European Central Bank to maintain liquidity, and CDS spreads—a measure of the cost of insuring against defaults on bonds issued by banks—have risen sharply (see Chart 2). The same stresses are not as evident in the U.S., although the Libor-Treasury and CDS spreads have risen in recent weeks.

Chart 2: Stress Mounts in Europe's Banking System

CDS spreads



Source: Bloomberg

Whether the current crisis of confidence becomes self-fulfilling and ignites a double-dip recession critically depends on how effectively policymakers respond. Policymakers must act aggressively to stabilize sentiment and lift flagging expectations.

Fiscal policy two-step

The Obama administration and Congress must accomplish two seemingly contradictory things at the same time in the next several months: Follow through on the debt-ceiling deal and agree to additional long-term deficit reduction while scaling back the near-term fiscal restraint that is already intensifying.

The debt-ceiling deal achieved in early August is a substantive step; it does not solve the nation's fiscal problems, but it goes more than halfway to the $4 trillion over 10 years in deficit reduction necessary to achieve a stable debt-to-GDP ratio. The deal cuts as much as $2.4 trillion in government spending over the next decade, of which $900 billion has already been identified and the remaining $1.5 trillion is to be determined by a super-committee of legislators by the end of November (see Table 1). If the super-committee process fails, there will be $1.2 trillion in automatic spending cuts over the next 10 years beginning in 2013, distributed evenly between defense and nondefense (mostly nonentitlement) outlays.

Table 1: Deficit Reduction Under the Debt-Ceiling Deal
Fiscal yrs, $ bil

	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2012-2021
Discretionary spending	-25	-46	-58	-66	-73	-79	-87	-95	-103	-111	-741
Mandatory spending	3	5	2	-3	-4	-4	-4	-5	-5	-5	-20
Debt service costs	0	-1	-3	-6	-10	-15	-20	-26	-33	-40	-156
Total excluding committee/triggers	**-21**	**-42**	**-59**	**-75**	**-87**	**-99**	**-112**	**-126**	**-141**	**-156**	**-917**
Committee/triggers											-1,500
Total											**-2,417**

Sources: CBO, Moody's Analytics

Policymakers have been able to circumvent budget rules in the past, beginning with Gramm-Rudman in the late 1980s, but this budget mechanism appears much more durable. Judging by the loud protests from those in Congress opposed to such cuts, they think so too.

The spending cuts will not be enough to achieve fiscal sustainability; policymakers will also likely need to raise tax revenues. However, this is unlikely to occur until the lead-up to the expiration of the Bush tax cuts, scheduled for the start of 2013. Since there is little political appetite for letting tax rates rise for everyone, policymakers could instead agree to tax reform that reduces the more than $1 trillion in annual deductions and credit (loopholes) in the corporate and personal tax code.

These so-called tax expenditures—because from an economic perspective they act no differently than government spending—are costly, add significantly to the complexity of the tax code, and generally benefit higher-income households. Limiting these loopholes and broadening the tax base could potentially raise a substantial amount of tax revenue and thus achieve fiscal sustainability, make the Bush tax cuts permanent and even lower marginal rates for corporations to improve the nation's global competitiveness.

Of course, tax reform will be politically difficult to pull off given that each loophole has a strident advocate willing to go to the mat for it. A plausible fallback would be to simply allow marginal personal tax rates to rise for those making more than $250,000 annually, the top income bracket. This would generate enough revenue to get close to fiscal sustainability. Many Republican legislators who have signed a no-tax pledge will not be happy with this, but they may have no choice, given the alternative of higher tax rates for everyone.

Policymakers have two very different paths immediately before them. If they take the current opportunity to make substantive and enduring reforms to entitlement spending and the tax code, the nation will achieve long-term fiscal sustainability, producing stronger long-term economic growth. If lawmakers fail to successfully execute on the debt-ceiling agreement, confidence will unravel and the economy will descend back into recession. The other major ratings agencies will downgrade U.S. Treasury debt; the

nation's fiscal problems will be overwhelming; and our long-term growth prospects will be meaningfully diminished.

Near-term fiscal drag

While policymakers must act to return the nation to long-term fiscal sustainability, they must also scale back the fiscal restraint that will hit in 2012. If no changes are made to current federal fiscal policy, it will shift from acting as a small drag on the economy this year to subtracting 1.7 percentage points from real GDP growth in 2012 (see Table 2).

Table 2: Fiscal Restraint in 2012 Under Current Policy

	Cost		GDP Impact	
	$ bil	% of GDP	$ bil	% of GDP
Change in deficit, 2011 vs. 2012	-371	-2.5	-261	-1.7
Cyclical deficit	-65	-0.4	0	0.0
Structural deficit	-306	-2.0	-261	-1.7
2% payroll tax holiday	-110	-0.7	-68	-0.5
Emergency UI	-50	-0.3	-58	-0.4
Accelerated depreciation	-22	-0.1	-5	0.0
State and local government aid	-50	-0.3	-56	-0.4
Infrastructure spending and other	-43	-0.3	-46	-0.3
Debt-ceiling deal	-31	-0.2	-28	-0.2

Source: Moody's Analytics

For context, at the peak of the federal fiscal stimulus in 2009, federal policy added 2.6 percentage points to real GDP growth. Yet as federal policy shifts from a stimulus to a restraint, the private sector must grow faster for the economy to simply grow at its potential–that rate of growth consistent with stable unemployment. In 2012 that potential is estimated at 2.7%; to reach it, private sector GDP would need to grow well above 4%. That seems unlikely given that growth has all but stopped recently.

The biggest drag next year under current federal policy comes from the scheduled expiration of two stimulus measures at the end of 2011: the current 2% employee payroll tax holiday and the emergency unemployment insurance program. Not extending the programs will shave 0.9 percentage point off 2012 real GDP growth and cost the economy some 750,000 jobs. The end of other fiscal stimulus measures enacted in 2009 will further reduce economic growth.

State and local government actions are already producing serious drags on the economy. Spending cuts and tax increases will shave an estimated 0.5 percentage point from real GDP growth this year and almost as much in 2012. The impact can be seen clearly in the job market. State and local governments have cut close to 700,000 jobs since their employment peaked three years ago and are continuing to shed workers at a stunning rate, averaging nearly 40,000 per month. Many of those losing their jobs are middle-income teachers, police, and other first responders.

Also adding to the need to reduce the near-term fiscal drag in current policy is the Federal Reserve's diminishing ability to respond to the weak economy. The Fed recently took a bold step, stating its intention to keep short-term interest rates near zero until mid-2013. This has brought long-term interest rates down and provided some support to stock prices. The Fed can provide even more help by extending the maturity of its current portfolio of Treasury bonds and by purchasing more long-term bonds in another round of quantitative easing. But even these policies are likely to be less effective at stimulating the economy than they might have been earlier.

Acknowledging this in his recent Jackson Hole speech, Fed Chairman Ben Bernanke essentially passed the ball to fiscal policymakers. Bernanke said Congress and the Obama administration must follow through on plans for long-term deficit reduction, but also must provide additional near-term support to the economy. Monetary policy alone may not be able to prevent another recession.

Additional fiscal help for the economy would not be desirable or even possible if the federal government's debt costs were rising or if government borrowing were tightening credit for households and businesses. But there is no evidence that such crowding out is occurring. Ten-year Treasury yields have fallen below 2%, a near record. This is in part because of the Fed's actions, but the U.S. also remains the global economy's safe haven. Whenever there is a problem anywhere, the investment of choice is a Treasury bond—witness the current flight to Treasuries sparked by financial turmoil in Europe. Borrowing costs for households and businesses also remain extraordinarily low, with fixed mortgage rates closing in on a record low of 4% and Baa corporate bonds (the lowest investment grade) yielding near a 50-year low of below 5.5%.

American Jobs Act

President Obama's much-anticipated jobs plan is a laudable effort to reduce this near-term fiscal restraint. If fully implemented, the Obama jobs plan would increase real GDP growth in 2012 by 2 percentage points, add 1.9 million jobs, and reduce the unemployment rate by a full percentage point, compared with current fiscal policy (see Table 3). That is, passage of the Obama jobs plan would mean that fiscal policy would be neutral with respect to the economy in 2012–neither a drag nor a spur to economic growth.

Table 3: President Obama's Jobs Plan
Budgetary cost, $ bil, calendar year

	2012	2013	10-Yr Cost
Total tax cuts and spending increases	421	63	447
Total tax cuts	293	-1	260
Payroll tax holiday for employees	175	0	175
Payroll tax holiday for employers	65	0	65
Accelerated depreciation	45	-1	5
Long-term unemployed hiring tax credit	8	0	8
Veterans hiring tax credit	0.1	0	0.1
Total spending increases	128	64	192
Unemployment insurance reforms	40	9	49
Infrastructure spending	25	25	50
Infrastructure bank	10	0	10
School renovations	20	10	30
Aid to state and local govts for teachers and first responders	20	15	35
Neighborhood stabilization	10	5	15
TANF work subsidies, summer job programs, other spending	3	0	3

Source: Moody's Analytics

The president's plan includes a wide range of temporary tax cuts and spending increases. Among its provisions are one-year extensions of this year's employee payroll tax holiday and the full expensing of business investment. Surprisingly, the plan would also increase the size of the temporary payroll tax cut and creatively expand it to employers. The president would also help state and local governments pay teacher and first-responder salaries, boost funding for unemployment insurance while meaningfully reforming the UI system, and launch several infrastructure initiatives.

The plan would cost close to $450 billion over 10 years, with slightly more than $250 billion coming from tax cuts and $200 billion from spending increases (see Table 4). For context, the plan's cost is equal to about 3% of current GDP and just over half the $825 billion ultimate price tag of the 2009 Recovery Act.

Table 4: Economic Impact of Obama Jobs Plan

	2011	2012	2013
Real GDP			
Obama jobs plan			
2005$ bil	13,295	13,850	14,234
% change	*1.6*	*4.2*	*2.8*
Current fiscal policy			
2005$ bil	13,295	13,586	14,105
% change	*1.6*	*2.2*	*3.8*
Moody's Analytics current baseline			
2005$ bil	13,295	13,652	14,118
% change	*1.6*	*2.7*	*3.4*
Payroll employment			
Obama jobs plan			
Mil	131.0	133.4	135.4
Change, mil	*1.2*	*2.4*	*2.0*
Current fiscal policy			
Millions	131.0	131.5	134.7
Change, mil	*1.2*	*0.5*	*3.2*
Moody's Analytics current baseline			
Mil	131.0	132.0	134.9
Change, mil	*1.2*	*1.0*	*2.9*
Unemployment rate			
Obama jobs plan	9.1	8.3	7.7
Current fiscal policy	9.1	9.3	8.1
Moody's Analytics current baseline	9.1	9.0	8.1
Federal budget deficit, FY			
Obama jobs plan			
$ bil	(1,320)	(1,386)	(886)
% of GDP	*-8.8*	*-8.7*	*-5.3*
Current fiscal policy			
$ bil	(1,320)	(1,079)	(880)
% of GDP	*-8.8*	*-6.9*	*-5.3*
Moody's Analytics current baseline			
$ bil	(1,320)	(1,164)	(874)
% of GDP	*-8.8*	*-7.4*	*-5.3*

Note: Current policy assumes that the Bush tax cuts are extended, the AMT is indexed to inflation, and the scheduled 30% reduction in Medicare payment rates for physician services does not occur. Moody's Analytics baseline differs from current policy in a number of ways, but most important in the near term is that it assumes an extension of the current payroll tax holiday for employees.

Note: These results are derived from simulations of the Moody's Analytics macromodel of the U.S. economy.

Sources: BEA, BLS, Treasury Department, Moody's Analytics

The largest tax cuts include an extension and expansion of the payroll tax holiday for employees and a creative new payroll tax holiday for employers. Employers would be permitted to reduce their payroll taxes by half on taxable wages up to $5 million annually. Businesses would also pay no additional taxes on any wages that rise from the year before, up to $50 million. This would give firms a substantial incentive to increase hiring and should result in a larger economic bang for the buck—additional GDP per tax dollar—than previous job tax credits such as last year's HIRE Act.

The president has also proposed a tax credit for businesses that hire people who have been unemployed longer than six months—a group that, astonishingly, includes half the jobless. The longer these workers remain unemployed, the harder finding work becomes as their skills and marketability erode. Structural unemployment thus rises as a long-term threat; it appears to have already risen from around 5% before the Great Recession to closer to 5.5% currently.

The Obama plan's most significant spending increases, totaling more than $100 billion, are for infrastructure. Such development has a large bang for the buck, particularly now, when there are so many unemployed construction workers. It can also help remote and hard-pressed regional economies and produce long-lasting economic benefits. Such projects are difficult to start quickly—"shovel ready" is in most cases a misnomer—but since unemployment is sure to be a problem for years, this does not seem a significant drawback in the current context.

More serious concerns are the expense of infrastructure projects and their often political rather than economic motivation. A creative way to address these concerns is through an infrastructure bank—a government entity with a federal endowment, able to provide loans and guarantees to jump-start private projects. These might include toll roads or user-supported energy facilities or airports. Private investors and developers would determine which projects to pursue based on what works financially rather than politically. The infrastructure bank would take time to launch, however, and thus would not produce quick benefits.

The president also proposes more funding for unemployment insurance, but in combination with some much-needed reforms to the UI system. One idea involves scaling up a Georgia program that places unemployed workers at companies voluntarily for up to eight weeks at no charge to the businesses. Along with their unemployment benefits, workers receive a small stipend for transportation and other expenses, training, and a tryout with the employer that could lead to a permanent job. Employers can potentially abuse the program by recycling unemployed workers, but the program seems to have had some success since it began in 2003.

Another idea to reform UI is to more broadly adopt "work share" as an alternative to temporary layoffs and furloughs. Instead of laying off workers in response to a temporary slowdown in demand, employers reduce workers' hours and wages across a department, business unit, or the entire company. The government then provides partial unemployment insurance benefits to make up for a portion of the lost wages. Work share

exists in 17 states and several countries overseas, including Germany, where it is credited for contributing to a relatively strong recovery.

Like the temporary extension of unemployment insurance benefits, work share has a large bang for the buck, since distressed workers are likely to quickly spend any aid they receive. Work share's economic effectiveness even exceeds that of straight UI benefits, because it reduces both the financial and psychological cost of layoffs. Work share can particularly help firms that expect reductions to be temporary, by reducing their costs for severance, rehiring and training.

Hard-pressed state and local governments would also receive additional relief under the president's plan. While state governments appear to be working through their near-term budget problems, local governments are still struggling with flagging property tax revenues. The biggest casualties are teachers and first responders, and Obama's plan would help with their salaries through the end of the 2013 school year.

Of the 1.9 million jobs added in 2012 under the president's plan, the largest contributor would be the extended payroll tax holiday for employees, which adds approximately 750,000 jobs. The payroll tax holiday for employers is responsible for adding 300,000 jobs, although this may be understated; quantifying the impact of this proposal is difficult. Infrastructure spending adds 400,000 jobs, 275,000 jobs are due to additional unemployment insurance funding, and 135,000 jobs result from more aid to state and local governments.

Drawbacks

The president's jobs plan has its drawbacks. At an estimated $450 billion, it is not cheap. Given that it must be paid for over the long run, this cost will only add to the burden of achieving fiscal sustainability. The president has proposed that the congressional super-committee consider reductions in various tax expenditures to pay for the plan. More likely, the committee will need to make even deeper spending cuts.

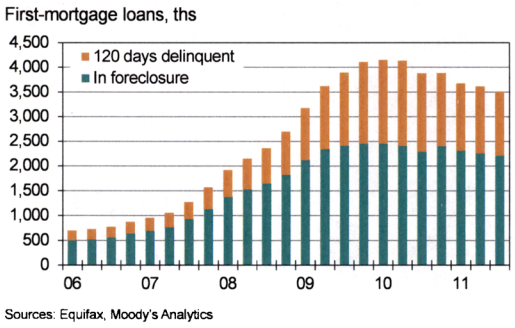
Another potential pitfall of the president's plan is that the boost to growth and jobs fades quickly in 2013. Additional infrastructure spending and aid to state and local governments will continue to support growth, but the benefits of the tax cuts will peter out. The hopeful assumption is that the private sector will be able to hold up as government support fades. While this is a reasonable hope, it is important to acknowledge that policymakers hoped for the same thing last year when they passed the one-year payroll tax holiday and extended emergency unemployment insurance through 2011.

The president's plan is large, but in some key respects, it is not complete. Most notably, it does not directly address the foreclosure crisis and housing slump, save for some added funding for neighborhood stabilization. In his speech, the president did say he would work with the FHFA (Fannie Mae's and Freddie Mac's regulator) to facilitate more mortgage refinancing; this would be a significant plus for housing and the broader

economy if he is able to break the logjam in refinancing.[ii]

With some 3.5 million first-mortgage loans in or near foreclosure and more house price declines likely, housing remains a major impediment to the recovery. (see Chart 3). A house is most Americans' most important asset; many small-business owners use their homes as collateral for business credit, and local governments rely on property tax revenues tied to housing values.

Chart 3: The Foreclosure Crisis Is Not Over



Sources: Equifax, Moody's Analytics

Most worrisome is the risk that housing will resume the vicious cycle seen at the depths of the last recession, when falling prices pushed more homeowners underwater—their loans exceeded their homes' market values—causing more defaults, more distress sales, and even lower prices. That cycle was broken only by unprecedented monetary and fiscal policy support.

The president's plan will be criticized for other reasons. Some will argue that he should have proposed massive public works, like the Depression-era WPA. Others will say the plan should have included broader reforms to corporate taxes or even immigration. Although these suggestions may have merit as policies, they seem like steps too far given what lawmakers need to do and how quickly they need to do it.

Policymakers need to work fast

The risk of a new economic downturn is as high as it has been since the Great Recession ended more than two years ago. A string of unfortunate shocks and a crisis of confidence are to blame. Surging prices for gasoline and food and fallout from the Japanese earthquake hurt badly in the spring; more recently, the debt-ceiling drama, a revived European debt crisis, and the S&P downgrade have been especially disconcerting. Confidence, already fragile after the nightmare of the Great Recession and Washington's heated policy debates, was severely undermined.

Whether the loss of faith in our economy results in another recession critically depends on how policymakers respond. Whether they will succeed in shoring up confidence is a difficult call. The odds of a renewed recession over the next 12 months are 40%, and they could go higher given the current turmoil in financial markets. The old adage that the stock market has predicted nine of the last five recessions is apt, but the recent free fall is disconcerting. Markets and the economy seem one shock away from dangerously unraveling. Policymakers must work quickly and decisively.

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[i] The Moody's Analytics weekly business survey has held up better, but it also has weakened significantly in recent weeks, with expectations regarding the outlook into next year and hiring intentions turning notably softer.

[ii] For a discussion of this and other ideas to help the beleaguered housing market, see "New Ideas for Refinancing and Restructuring Mortgage Loans," testimony before the Senate Banking Committee, Mark Zandi, September 14, 2011.

Chairman CONRAD. Thank you.

And now we will go to Dr. Stone. Chad, welcome back.

Why do you not proceed with your testimony, and then we will go to Dr. Hassett, and then we will open it up to questions.

STATEMENT OF CHAD STONE, PH.D., CHIEF ECONOMIST, CENTER ON BUDGET AND POLICY PRIORITIES

Dr. STONE. Thank you. Chairman Conrad, Senator Sessions, and other members of the committee, thank you for the opportunity to testify today on Policy Prescriptions for the Economy. I am also pleased to be here as a proud alumnus of the Conrad Budget Team, as the Senator mentioned earlier.

I want to talk about, briefly, three major themes that are in my written testimony more completely. The first is that under current economic conditions, activities like those proposed in the President's jobs package, and that Mark just mentioned and that Senator Conrad's chart laid out, can provide a boost to economic activity and move the needle on jobs.

Second, in the current economic environment, the alternative view that is often expressed, that what we need is immediate sharp reductions in government spending, and that that is the best way to get the economy out of the doldrums, that is not supported by the evidence. That will not work and probably would make things worse.

And third, this is, as the Senator's quote from CBO Director Elmendorf said and as other witnesses will say, I am sure—have said and will say—we need to combine short term efforts to get the economy out of the doldrums with longer-term deficit reduction efforts, and in those deficit reduction efforts, we need to have a package that is balanced, where revenues are part of it, and also, especially in light of the evidence that came out this week in the report from the Census Bureau on income, poverty, and health insurance coverage, which show several years of increasing bad numbers in that regard in this weak economy, we need to be protective of low-income households in the efforts that we make to reduce the budget deficit.

So I am going to discuss our short-run challenge and our long-run challenge in the context of a chart that is in my testimony. My testimony has the right-hand panel of that chart. This is a chart that shows CBO's estimate of potential GDP—that is the blue line or the straight line—and what is happening with actual GDP.

So pursuing the analogy in the title of this hearing, prescriptions, I think it is vitally important that if we want to come up with the right policy prescriptions for the economy, we need to make the right diagnosis of what is wrong. Most importantly, we want to distinguish between, on the one hand, the effects of an acute disease that has laid us low in the short term and that we are still struggling to recover from—that is the 2007–2009 financial crisis and recession. That is the huge drop in GDP below what the economy is capable of producing, the opening up of huge excess unemployment and economic slack in the economy. That is our acute problem, a jobs deficit, an output deficit.

On the other hand, there is another problem, and that is the reckless disregard for the long-term health of the economy over the

last decade that we have shown by abandoning, despite the efforts of this committee, the fiscal discipline that produced a balanced budget in the late 1990s and failing to prepare for the stresses the retirement of the baby boom generation will put on the budget. Those issues affect the blue line, potential GDP, what our long-term capacity to produce goods and services is.

So these are two distinct problems. The challenge is that if we try to correct our long-term bad habits too quickly, we will endanger our recovery from the acute illness. But if we just go back to our old habits, we will leave ourselves open to a number of problems that will weaken us in the future.

So enough of the health metaphor. I am a doctor, but not that kind of doctor, so let us talk about the economics.

My prescription, which follows in the spirit of what CEO Director Elmendorf said, and my testimony includes a similar quote from Fed Chairman Bernanke, is that we can, in fact, engage in activities to boost the economy in the short run and engage in long-run deficit reduction. It is a question of timing.

So the chart, as I said, shows that, from the red line, the economy fell into a deep hole—the short run, acute problem—fell into a deep hole in 2008–2009 relative to our potential. Actions by the Fed, the Congress, and two administrations kept things from being even worse, but we are really struggling to recover. We have a long way to go to get back to potential. What short-run policies do is move the red closer to the blue line faster, fill in the jobs hole. There is a lot of economic hardship associated with that gap. There are unemployed workers, businesses that have failed, poor people who have a much harder time finding a job.

So that is why I think that actions by the Fed—I am sorry. That is why I think that policies that stimulate economic growth, stimulate economic activity in the short run, like those in the President's proposal, can move that red line. Dr. Zandi's estimates suggest that they would.

In the late 1990s and in 2006 and early 2007, I would not be recommending these kinds of policies. I am recommending them now for the short term when there is a big gap. When the economy is back to full employment, stimulus of this sort does not work. It is merely offset by changes in Fed policy. But when we are down, it does work.

The key to effective stimulus, whose goal is to put people back to work and businesses back to full production, is to put money into the hands of people who will spend it. That is why policies like unemployment insurance and the payroll tax cut will be effective in stimulating economic activity and job creating. Policies to give businesses incentives to expand their capacity to produce goods and services less effective because they are already having trouble producing up to full capacity.

With respect to the second argument, the alternative argument that large cuts in government spending are the best way to get the economy going, I am familiar with the work of Harvard economist Alberto Alesina that people cite as supporting this position. And I am also familiar with the fairly substantial critique of that evidence that has been developed more recently. The evidence shows that if you look at those episodes, almost none—in fact, none of the

successful fiscal episodes that were associated with growth remaining strong took place in a weak economy like the one we are experiencing now. On the other side, almost all of the unsuccessful episodes—I am sorry. Let me say that the right way. If you are in a weak economy, that kind of short, sharp fiscal adjustment is almost bound to fail. You will have to go back on it because the economy will weaken.

Third, with respect to long-term deficit reduction, nothing I am saying about the need for action now should deny the fact that we need action for the long term, that we need a credible deficit reduction plan to be put in place, put in place now but to take effect down the road when the economy is stronger.

We at the Center on Budget and Policy Priorities have developed a set of principles for that. We believe strongly that such a policy needs to be balanced, that you cannot leave revenues off the table. You can start out with the tax expenditures and loopholes that Dr. Zandi mentioned, but to be credible and to achieve long-term success, it has to be a balanced package that includes revenues, ideally, a 50-50 mix.

And finally, to come back to a theme I had mentioned earlier, and we are thinking about it a lot at the Center right now, especially in light of the income and poverty numbers, is that we should follow the recommendations of the Bipartisan Budget Committee, the Bipartisan Deficit Commissions, and the actions that we have taken in past efforts to reduce the budget deficit, and that is to not impose a further burden on the poorest people in our society, to protect the low-income programs in our deficit reduction efforts.

Thank you.

[The prepared statement of Dr. Stone follows:]

Center on Budget and Policy Priorities

820 First Street NE, Suite 510
Washington, DC 20002

Tel: 202-408-1080
Fax: 202-408-1056

center@cbpp.org
www.cbpp.org

September 15, 2011

TESTIMONY OF CHAD STONE
Chief Economist, Center on Budget and Policy Priorities

Before the
Senate Budget Committee
United States Congress

Policy Prescriptions for the Economy

Chairman Conrad, Senator Sessions, and other members of the Committee, thank you for the opportunity to testify today on policy prescriptions for the economy.

To use the medical analogy in the title of this hearing, the U.S. economy is experiencing a long and difficult recovery from a severe acute illness — the 2007-2009 financial crisis and recession — and remains weak, with the risk of a relapse. Separately, U.S. policymakers have behaved with a reckless disregard for the long-term health of the economy over the last decade by abandoning, despite the efforts of this committee, the fiscal discipline that produced a balanced budget in the late 1990s and by failing to prepare for the stresses the retirement of the baby boom generation will put on the budget. Contrary to much of the rhetoric during the recent debt-ceiling debate, however, the United States' current acute economic problems — sluggish growth, a huge jobs deficit, and stubbornly high unemployment — do not stem directly from a lack of fiscal discipline, and a premature application of fiscal rectitude will do more harm than good.

My policy prescriptions follow from this diagnosis. First, it is time reject the arguments prominent in the debt ceiling debate that excessive government spending and the buildup of debt since 2008 are the causes of our current economic troubles and that cutting spending sharply and quickly is the cure. Indeed, the economic situation today cries out for significant fiscal *stimulus* such as that proposed in President Obama's American Jobs Act. Providing that stimulus can be accomplished without compromising our long-term fiscal stabilization objectives by pairing it with a credible program of deficit reduction that does not kick in immediately but rather is deferred until a time when the economy is expected to be stronger. I believe the economic risks from failing to provide fiscal support to the flagging economic recovery are much more significant than the economic risks from temporarily running larger budget deficits.

My prescription is fully consistent with mainstream economic analysis like that underlying recent statements by Congressional Budget Office (CBO) Director Doug Elmendorf and Federal Reserve Chairman Ben Bernanke, each of whom recognizes that the economy is currently fragile and short-term fiscal stimulus is not incompatible with longer-term fiscal restraint.

Testifying before the Joint Select Committee on Deficit Reduction earlier this week, Elmendorf said:

> There is no inherent contradiction between using fiscal policy to support the economy today, while the unemployment rate is high and many factories and offices are underused, and imposing fiscal restraint several years from now, when output and employment will probably be close to their potential. If policymakers wanted to achieve both a short-term economic boost and medium-term and long-term fiscal sustainability, a combination of policies would be required: changes in taxes and spending that would widen the deficit now but reduce it later in the decade. Such an approach would work best if the future policy changes were sufficiently specific and widely supported so that households, businesses, state and local governments, and participants in the financial markets believed that the future fiscal restraint would truly take effect.[1]

In a speech on the U.S. economic outlook last week, Bernanke said:

> [W]hile prompt and decisive action to put the federal government's finances on a sustainable trajectory is urgently needed, fiscal policymakers should not, as a consequence, disregard the fragility of the economic recovery. Fortunately, the two goals — achieving fiscal sustainability, which is the result of responsible policies set in place for the longer term, and avoiding creation of fiscal headwinds for the recovery — are not incompatible. Acting now to put in place a credible plan for reducing future deficits over the long term, while being attentive to the implications of fiscal choices for the recovery in the near term, can help serve both objectives.[2]

The rest of my testimony is an elaboration on these themes. In it, I stress the importance of differentiating between 1) the longer-term policies needed to produce sustainable growth and broadly shared prosperity *at* high levels of employment and 2) the short-term policies needed to *restore* high levels of employment in the wake of a deep recession. In particular, policies aimed at reducing the budget deficit are a key ingredient of longer-term policy but are likely to be counterproductive in the short run if implemented too precipitously.

I make the case for fiscal stimulus in the short term to support the economic recovery; I discuss recent analysis confirming the conventional wisdom that cutting the budget deficit too much too fast — whether through spending cuts, revenue measures, or a combination of the two – is harmful to the recovery; and I discuss why long-run fiscal stabilization should be achieved through a balanced package of spending and revenue measures that protects low-income programs, as recommended by recent budget commissions and as was done in previous major deficit reduction efforts.

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[1] Douglas W. Elmendorf, Director, Congressional Budget Office, "Confronting the Nation's Fiscal Policy Challenges," statement before the Joint Select Committee on Deficit Reduction, U.S. Congress, September 13, 2011. http://www.cbo.gov/doc.cfm?index=12413

[2] Ben S. Bernanke, Chairman, Federal Reserve Board, "The U.S. Economic Outlook," speech at the Economic Club of Minnesota Luncheon, September 8, 2011. http://www.federalreserve.gov/newsevents/speech/bernanke20110908a.htm

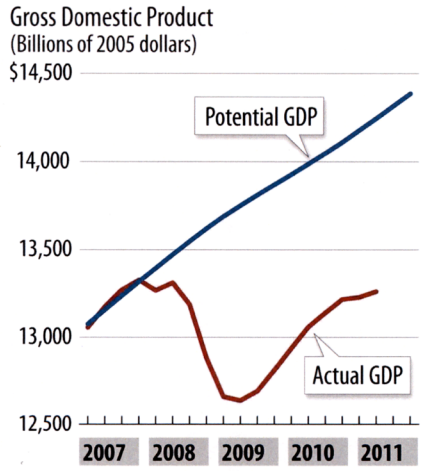
The Case for Fiscal Stimulus

A host of developments precipitated by the bursting of the housing bubble threw the U.S. economy into a deep hole in 2008 and the first half of 2009, with for the output of goods and services (actual GDP) falling well below what the economy was capable of supplying with high employment, normal labor force participation, and full utilization of existing capacity (potential GDP). Extraordinary monetary and fiscal policy measures undertaken by the Federal Reserve, Congress and two administrations arrested the fall and kept the hole from getting deeper,[3] but we are still trying to dig out of that hole and we've had limited success so far. (Figure 1)

The Problem of Excess Capacity

There is tremendous economic waste and human hardship in an economy that is operating well below full capacity. The goods and services that are not produced, the wages and business income that is not earned, and the revenues not received are lost forever. Potential GDP is effectively a ceiling on sustainable production, so periods of severe economic slack such as we are currently experiencing are not offset in the future by periods when actual GDP exceeds potential by a comparable amount.

FIGURE 1:
Economy Operating Well Below Full Capacity



Sources: Bureau of Economic Analysis and Congressional Budget Office

CBO estimates that the recession and subsequent economic slump have already cost the economy $2½ trillion in lost output (the cumulative gap between actual and potential GDP since late 2007) and that without a pickup in the expected pace of recovery, we will lose another $2½ trillion before getting back to full employment. Moreover, as CBO notes, "Not only are the costs associated with the output gap immense, but they are also borne unevenly, falling disproportionately on people who lose their jobs, who are displaced from their homes, or who own businesses that fail."[4]

[3] See Alan S. Blinder and Mark Zandi, "How the Great Recession Was Brought to an End," July 27, 2010. http://www.economy.com/mark-zandi/documents/End-of-Great-Recession.pdf

[4] Elmendorf, *op. cit.*

Policies that reduce the size of the output gap along the way to restoring full employment reduce the economic costs and human hardship of an economic slump. Long-term unemployment is at unprecedented levels, and as Tuesday's grim report from the Census Bureau on income, poverty, and health insurance in 2010 shows, the recovery is proceeding too slowly to reduce that hardship substantially anytime soon.

A large output gap stems mainly from inadequate aggregate demand for goods and services, and policies that increase aggregate demand are likely to be more successful at closing the output gap than policies that give businesses tax incentives to expand production. The problem for most businesses in an economic slump is not that they don't have enough capacity to meet existing demand but that they don't have enough demand to fully utilize their existing capacity. Thus policies that put more customers in the stores with more money to spend are likely to be more successful at closing the output gap and creating jobs than giving businesses tax breaks. Policies that focus on raising the purchasing power of unemployed workers and middle- and low-income households are likely to be more successful per dollar of budget costs at increasing spending and creating jobs than policies cutting tax rates for high income taxpayers who are likely to save a significant portion of any tax cut they receive.

Policies to Increase Aggregate Demand

Fiscal stimulus in the form of tax cuts aimed at middle and lower income households, relief for state and local governments to avoid layoffs of teachers and other critical employees, direct transfers to unemployed workers, and direct spending on infrastructure are all measures that can effectively raise aggregate demand under the right circumstances.

Prior to the Great Recession, mainstream economists were confident that monetary policy could moderate swings in the business cycle and skeptical that fiscal stimulus could be implemented quickly enough to be effective in the mild run-of-the-mill recessions thought likely to occur. The problem was not that cutting taxes and increasing government spending would not be able to increase aggregate demand but rather that the economy would already be recovering by the time the boost to economic activity kicked in and the Fed would react by tightening monetary policy (raising interest rates) to offset the by-then-unwanted stimulus.

That is not the situation we have been in since the recession began, and the Fed has stated that it does not anticipate raising interest rates over the next two years. According to most forecasts, we face a long period of high unemployment and excess productive capacity. These are just the economic circumstances in which appropriate fiscal stimulus will likely be most effective in stimulating demand and creating jobs.

CBO estimates that under these circumstances,

- purchases of goods and services by the federal government and transfers to state and local governments for infrastructure would have a multiplier (additional economic activity per dollar spent) of between 1.0 and 2.5 (once the money is actually dispersed
- transfers to individuals (such as unemployment compensation) would have a multiplier of 0.7 to 1.8,

- tax cuts for lower- and middle-income people would have a multiplier of 0.6 to 1.5.

In contrast,

- tax cuts for higher income people would have a multiplier of 0.2 to 0.6, and
- tax cuts for businesses primarily affecting cash flow (such as the net operating loss provision in the 2009 Recovery Act and the foreign dividend repatriation proposals now circulating) would have a multiplier of 0.0 to 0.4.

These are the multipliers CBO estimates would apply to provisions in the 2009 Recovery Act, which CBO estimates boosted GDP in 2010 by between 1.5 and 4.2 percent, boosted employment by between 1.3 and 3.3 million jobs, and lowered the unemployment rate by between 0.7 and 1.8 percentage points compared with what they would have been without those measures. The contribution of the various measures in the Recovery Act to those results are a function of how much money was spent, the timing of that spending, and the estimated multiplier for that type of spending.

Private forecasters like my co-panelist Mark Zandi and Macroeconomic Advisers also attribute positive macroeconomic effects to the Recovery Act, the payroll tax holiday and extension of unemployment insurance benefits in the tax/unemployment insurance compromise enacted at the end of last year, and the President's latest American Jobs Act proposals.

I know there is a popular perception that the Recovery Act stimulus "failed" because the unemployment rate has exceeded even the rate the White House (and most other forecasters at the time) expected in the absence of any policy, much less the rate predicted if the policy was enacted. But what we have learned subsequent to those forecasts is that the underlying economy was deteriorating much more rapidly than those forecasts assumed. The recent revisions to GDP show that the economic decline in late 2008 and early 2009 was much sharper than was originally estimated. Others may produce different estimates of how much of an impact the Recovery Act had in preventing economic performance from being even worse than it was, but the comparison should be to a plausible counterfactual of what the economy would have looked like in the absence of the policy not to a baseline pre-policy forecast that in retrospect was much too rosy.

I believe the case for fiscal stimulus is compelling in an economy with substantial economic slack, a huge jobs deficit, and stubbornly high unemployment. Policies that are easy to implement, have high bang-for-the-buck, and relieve hardship should be top candidates. At a bare minimum, of course, the payroll tax cut and federal unemployment insurance should be extended for another year to prevent their scheduled expiration from imposing an additional drag on the recovery. But the President was right to go beyond merely treading water and propose additional measures like expanding the payroll tax cut, infrastructure investments, and aid to states to prevent layoffs of teachers and other essential workers.

Policies that will add the budget deficit without providing additional stimulus should not be part of a stimulus package. These include a repatriation holiday for foreign earnings of U.S. multinationals and other corporate tax cuts.

The False Promise of Expansionary Fiscal Austerity

Deficit reduction is critical to long-term growth, but reducing deficits too much or too fast in a weak economy is counterproductive. That mainstream economic view has been challenged recently by claims that immediate large reductions in government spending are necessary for successful deficit reduction and can be good for the economy even in the short run. Supporters of this claim point to empirical studies of major deficit-reduction initiatives by other countries.[5] These studies, they argue, show that programs composed largely of spending cuts are more likely to be successful at stabilizing deficits — and less harmful (and even beneficial) to the economy in the short run — than programs with a larger tax-increase component.

Recent research has cast serious doubt on these claims and on the relevance of this evidence to current economic and budget conditions in the United States. The International Monetary Fund, after correcting for potential biases in the way fiscal austerity episodes are usually identified in this literature, concludes, "The idea that fiscal austerity triggers faster growth in the short term finds little support in the data."[6] Konczal and Jayadev found that ***none*** of the episodes cited in one of the most prominent studies in this literature — by Harvard economists Alberto Alesina and Sylvia Ardagna[7] — took place in a country still feeling the effects of a large recession as the United States is now, with substantial economic slack, tepid economic growth, and high unemployment.[8] The Congressional Research Service's examination of the same literature concludes, "fiscal adjustments beginning in a slack economy (such as the current situation in the U.S.) appear to have a low probability of success."[9]

Advocates of spending-heavy deficit reduction argue that even if it is not expansionary in the short run, it is still preferable to tax-based deficit reduction because it is more likely to result in lasting results and does less harm to the economy in the short-term. This finding too has little relevance to current U.S. economic and budget conditions.

Successful, short-sharp fiscal contractions are usually accompanied by a rapid decline in interest rates, a moderation of wage growth, and an improvement in the trade balance. But U.S. interest rates are already low and the Fed does not have the option of lowering them much further in order to offset the contractionary effects of immediate deficit-reduction measures, whether tax- or spending-based. It would be very difficult for the United States to increase exports enough to offset

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[5] Joint Economic Committee Republicans, "Spend Less, Owe Less, Grow the Economy," March 15, 2011: http://www.speaker.gov/UploadedFiles/JEC_Jobs_Study.pdf

[6] International Monetary Fund, "Will It Hurt?" Chapter 3 in World Economic Outlook, October 2010. http://www.imf.org/external/pubs/ft/weo/2010/02/pdf/c3.pdf

[7] Alberto F. Alesina and Sylvia Ardagna, Large Changes in Fiscal Policy: Taxes versus Spending, Working Paper 15438, National Bureau of Economic Research, October 2009. http://www.nber.org/papers/w15438.pdf?new_window=1

[8] Arjun Jayadev and Mike Konczal, ," The Boom Not The Slump: The Right Time For Austerity", The Roosevelt Institute, August 23, 2010, http://www.rooseveltinstitute.org/sites/all/files/not_the_time_for_austerity.pdf?" http://www.bis.org/events/conf110623/perotti.pdf

[9] Jane G. Gravelle and Thomas L. Hungerford, "Can Contractionary Fiscal Policy Be Expansionary?" Congressional Research Service Report R41849, June 6, 2011.

those contractionary effects when other developed countries also are trying to reduce their budget deficits and get out of an economic slump by expanding their exports. And neither public nor private wages are growing faster than productivity.

In the latest summary of its findings, "Painful Medicine: Although advanced economies need medium-run fiscal consolidation, slamming on the brakes too quickly will hurt incomes and job prospects," the IMF flatly rejects the idea that deficit reduction would be expansionary in countries facing a weak recovery:

> Will deficit reduction lead to stronger growth and job creation in the short run?
>
> Recent IMF research provides an answer to this question. Evidence from data over the past 30 years shows that consolidation lowers incomes in the short term, with wage-earners taking more of a hit than others; it also raises unemployment, particularly long-term unemployment.[10]

The Congressional Research Service summarizes its examination of the austerity literature this way:

> The findings in the Alesina and Ardagna study that successful debt reductions were associated with higher growth when spending cuts were used was based on 9 observations out of 107 instances of deficit reduction, or less than 10% of the sample. In addition, most of the countries where debt reductions were successful were at or close to full employment, while the United States remains well below full employment, raising questions as to whether this evidence is applicable to current U.S. conditions. Thus, both methodological questions and questions of applicability to current circumstances can be raised for the Alesina and Ardagna, and similar, studies.

Finally, Roberto Perotti, one of the leading researchers cited by supporters of spending-heavy deficit reduction, recently conducted detailed case studies of the four largest multi-year deficit-reduction efforts that researchers have commonly regarded as spending-based. He found that they were actually much smaller, and much less tilted toward spending cuts, than previous studies had assumed.[11]

The claim that government spending is crowding out productive private investment at a time when the economy has considerable economic slack goes as much against mainstream economic analysis as the arguments that deep budget cuts in a weak economy will trigger stronger growth and job creation. For government spending to crowd out private spending, the workers, factories, and machines needed to meet the demand generated by the government spending would have to be diverted from other productive activities. To be sure, that can occur in a high-employment economy with no economic slack. But the current situation is very different. For example, when the government provides additional unemployment insurance (UI) benefits to workers struggling to

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[10] Lawrence Ball, Daniel Leigh, and Prakash Loungani, "Painful Medicine," *Finance and Development*, September 2011, p. 20.

[11] Roberto Perotti, "The Austerity Myth: Gain without Pain?" June 16, 2011. http://www.bis.org/events/conf110623/perotti.pdf

find a job, businesses are helped rather than harmed: the benefits increase consumer demand for goods and services and thereby enable businesses to put unemployed workers back to work and put idle capacity back into production (or to refrain from cutting workforces and production even further).

The crowding out argument would have more force if the economy today looked more like the economy in the 1990s expansion — the longest in our country's history and the last time we had a balanced budget. But in today's economy, weak demand, not competition for funds, is the much more plausible explanation for inadequate investment and job creation.

In summary, despite claims to the contrary, conventional economic wisdom still rings true: austerity and growth do not mix in the short term. Empirical support for the view that sharp, immediate cuts in government spending would be good for the U.S. economy was never strong, and it's getting weaker.

Principles for Long-Term Deficit Reduction

My discussion of the desirability of enacting policies to support the economic recovery and my critique of arguments for large immediate spending cuts should in no way be interpreted as minimizing the importance of meeting our long-term budget challenge. But we do have time to meet that challenge in a responsible way.

The Center on Budget and Policy Priorities laid out its principles for deficit reduction along with some cautions in March.[12] The overall objective should be to stabilize the debt as a share of GDP in a reasonable period of time, but as I have discussed in this testimony, not so quickly as to endanger the recovery. In pursuing this goal, policymakers should follow a series of principles that would make deficit-reduction efforts equitable and more likely to be effective and sustainable over time. At the same time, they should avoid a series of steps that not only would make deficit cutting harder to achieve and sustain but also would hurt the economy down the road.

As CBO Director Elmendorf testified before the Joint Select Committee on Deficit Reduction earlier this week, "The nation cannot continue to sustain the spending programs and policies of the past with the tax revenues it has been accustomed to paying. Citizens will either have to pay more for their government, accept less in government services and benefits, or both."

Recognizing that reality, CBPP believes that any deficit-reduction plan should be balanced and inclusive, affecting all parts of the budget and with the savings split about 50-50 over time between program reductions and revenue increases. A substantial share of the new revenues should come from scaling back "tax expenditures:" the more than $1 trillion a year in tax breaks that the tax code provides each year for particular taxpayers or groups of taxpayers. Policymakers should avoid misguided proposals such as those that would place a statutory cap on total annual federal spending or write a balanced budget requirement into the U.S. Constitution — either of which would diminish the government's ability to respond effectively to recessions (and, in fact, would make recessions worse) while largely or entirely shielding taxes from deficit-reduction efforts.

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[12] Robert Greenstein, "A Framework for Deficit Reduction, Principles and Cautions," Center on Budget and Policy Priorities, March 24, 2011. http://www.cbpp.org/cms/index.cfm?fa=view&id=3435

I want to particularly highlight one final principle. Policymakers should avoid making the problems of poverty and inequality, both of which are higher in the United States than in most other Western industrialized nations, still worse. Policymakers should adopt and adhere to the principle espoused in the Bowles-Simpson deficit-reduction plan to protect the disadvantaged. The major deficit-reduction packages of 1990, 1993, and 1997 all generally protected programs for low-income Americans; those packages, in fact, reduced poverty and inequality even as they reduced deficits.

The last point becomes even more crucial in light of the grim figures in this week's report from the Census Bureau on income, poverty, and health insurance in 2010, which showed that the share of all Americans and the share of children living in poverty, the number and share of people living in "deep poverty," and the number without health insurance all reached their highest level in many years — in some cases, in several decades — while median household income fell significantly after adjusting for inflation.

The extent and depth of poverty in coming years and decades will be strongly affected by whether the Joint Committee on Deficit Reduction, and Congress as a whole, adhere to a core principle that the commission chaired by Erskine Bowles and Alan Simpson set forth in its report and the Senate's "Gang of Six" sought to honor in its plan — that deficit reduction should be designed so that it does not increase poverty and should therefore shield low-income assistance programs from cuts — or whether the Joint Committee and Congress instead impose significant cuts in programs for those at the bottom of the income ladder.

Conclusion

The U.S. economy continues to struggle to recover from the severe 2007-2009 recession and subsequent protracted slump. We can take positive steps to give the recovery a boost without endangering efforts to stabilize our long-term debt. That will reduce the economic waste and human hardship that are evident in the current weak recovery. When we turn to the long-term budget challenge, we can and should protect the most vulnerable among us in order to reverse the recent history of poverty becoming wider and deeper.

Chairman CONRAD. Thank you.

Now, we will go to Dr. Hassett. Welcome. Please proceed.

STATEMENT OF KEVIN A. HASSETT, PH.D., SENIOR FELLOW AND DIRECTOR, AMERICAN ENTERPRISE INSTITUTE FOR PUBLIC POLICY RESEARCH

Dr. HASSETT. Thank you, Chairman Conrad, Ranking Member Sessions, other members of the committee. It is an honor and a pleasure to be here again.

As you might have noticed, my testimony got a little out of hand, 14 single-spaced pages, so I am not going to attempt to read it but rather will try to get to the main points in as brief amount of time as I can. And really, I think that there are five things I would like to talk about and will do so extemporaneously.

I think that the question that you asked in the letter about why has growth been slow is something that we at the American Enterprise Institute have been studying very hard, even before the financial crisis, as you mentioned. You cited Vincent Reinhart as Carmen Reinhart's husband and they have been working together, as well, with Kenneth Rogoff on this, and I think that the basic idea is not only that after a financial crisis that you have slow growth for a good long time, but as we at AEI have been digging into it more, we also understand the forces that cause that to happen and one of them is the debt-to-GDP factor that is mentioned that is also a different set of work by Reinhart and Rogoff, but also has been follows up by an excellent IMF study that I commend to you that shows that when debt-to-GDP gets above a certain level, then that really has a negative effect on growth. I think that, really, you should reduce the CBO outlook over the next ten years by maybe about half a percent to account for that effect.

But there are a couple of other important effects, too, things that we are seeing ourselves now. One of them is that because the crises tend to create deeper recessions that last longer, then long-term unemployment starts to be a real issue. When people separate from the workforce and then stay out for more than six months or so, then it gets really, really hard for them to be hired again. Imagine if a worker came to you and asked to be hired and then had not had a job in two years. You might wonder, what is wrong with this guy? That is a terrible struggle for people, that more and more Americans, sadly, are going through right now, and that in other countries people have gone through that stress, as well.

And the final thing is that the rebuilding of the balance sheet takes a good long time, that there are a lot of bad assets, assets that are on books that maybe we are pretending are worth more than they are when we are looking at our financial institutions that take a long time to work out, and until that happens, there is this uncertainty, this overhang that causes a drag on the economy, especially the real estate market right now. And so if you have got an underwater real estate investment, maybe you have not sold it yet, but until you do, you will not feel liquid and optimistic enough to move forward.

And so I think that hearing that that is the experience, I think that we can all agree, as you stipulated, Mr. Chairman, in your opening statement, that this is what we are in for, is a long, tough

slog that looks a lot like the slogs that others have had to go through. Indeed, back in 2009 in the stimulus hearings in the House when I was testifying and saying this is what I think is going to happen—it was consistent, I guess, with your views at that time—then I was criticized as too pessimistic, but I show you a chart in my testimony that shows that actually what we thought would happen was better than what actually happened. We are below——

Chairman CONRAD. Can I just stop you on that point? You and I had the same criticism directed at us——

Dr. HASSETT. Right.

Chairman CONRAD [continuing]. Because we were saying very much the same thing at that time, that we are headed on an unsustainable course. I know you were heavily criticized for that, being overly pessimistic. I was, as well. I wish we had been wrong.

Dr. HASSETT. Yes. Well, we were wrong, but on the wrong side. [Laughter.]

And the thing that I want to add, though, is that I think that if we accept that view, then it argues very strongly against the type of economic policies that we have adopted and many of the proposals of the President, and I think you will notice in my testimony that I played it absolutely straight. I went through each of his major proposals, and some of them, I like and I said so.

But the overarching observation that I think is absolutely essential that policy makers grab right now, or grasp right now, is that if we are in for a long slog out, then these short-term Keynesian policies are exactly the wrong medicine, and here is why. Mr. Zandi and I have been friends for a long time and we have different ideas about what the multiplier is. I think it is smaller. He thinks it is larger. But even if we accept Dr. Zandi's multiplier, then there are three stages to a Keynesian stimulus. There is the point when you put it in. There is the point where you take it out. And then there is the point where you pay for it.

Now, if you have a multiplier of two, then if we put in $100 billion, then you get $200 billion. But when you take it out, then you are taking out $100 billion and you lose $200 billion. You are kind of back where you started.

And so in a typical post-war recession that lasts 11 months and has growth of six percent in the year after, then if we could move a couple of percent of GDP growth from next year to this year, you could really accomplish some good. You could imagine that that would be a good thing to do. But notice that you have to have the strong assumption at the outset that you are timing the down well, too, because you know it is going to be six percent growth next year so it is okay to lose a couple percent growth when we withdraw the stimulus.

But then there is the third part, which is when we pay for it. You have to raise taxes or maybe you issue debt forever or something. But when you pay for it, that has a negative effect on the economy, too.

And so the total effect over time—and you see that in the CBO estimates of even these Keynesian things—in the long term, the total effect is negative because there is an up and a down that

about cancel and then you pay for it and that is a negative, and so on net it is a negative.

Now, what I assert, and I believe this absolutely, is that if you are in a ten-year recovery of a financial crisis, then you are absolutely guaranteed to have the negative stuff happen when you cannot afford to take it. You are going to have a hangover when you cannot afford it, and that is why we cannot have another temporary stimulus right now.

But that does not mean that we should not act, and if you look at the rest of my testimony, you will see that I think there are two measures that, if adopted right now, could really have a big positive effect on the trajectory of the United States and an immediate one, as well.

The first thing I do is I reviewed the fiscal consolidation literature, and I know I have spoken to Dr. Stone about that literature before. He was my professor at Swarthmore. I think we pretty much agree that there has been some excessive optimism about what you get about this fiscal consolidation. I discussed that in my testimony.

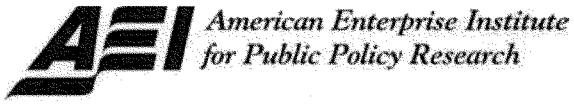
But the one thing that you do learn from the literature, even the critics of Alesina, is that a successful consolidation mostly comes from spending cuts, about 85 percent, on average, as the chart shows in my testimony. And the other thing that we learn from fiscal consolidation literature is that the growth effects do not necessarily have to be negative. Indeed, if you focus the fiscal consolidation on entitlement cuts, especially long term entitlement cuts, then even the IMF study that is very critical of Alesina finds that near-term growth effects are positive. I mean, they are not glorious, but they are positive, which means that you can have a fiscal consolidation and not be concerned that the Keynesian effects are going to crush you if you focus the consolidation on reforming entitlements.

The second thing, and the last part of my testimony where I go into what to do now, I review, again, some work that has got a very bipartisan basis. Alan Auerbach, who is a very well known Democratic economist and my dissertation advisor, and I wrote a book on tax reform where we summarized the literature and cited some work of Alan Krueger, who is about to be, or has been the nominee for the CEA Chair, that showed that—they surveyed economists and said, what do you get out of a fundamental reform in terms of growth, and the median estimate was about a percent a year for a good long time.

Auerbach and I conclude in our book that you get half a percent to a percent a year over a decade of extra growth if you would have a tax reform, fundamental tax reform. And if you had a big corporate reform that included a cut in the corporate rate, as was recommended by Dr. Zandi, you could get big immediate effects of that because the corporate tax is so intricately connected to equity values and so on.

So I think that it is clear how to go forward. We need to really play it big now. We need to have a fiscal consolidation and a fundamental tax reform that can immediately stimulate the economy, but not with policies that give us a hangover two years from now but rather with permanent fixes.

Thank you very much, Mr. Chairman.
[The prepared statement of Dr. Hassett follows:]



Testimony before the Senate Committee on the Budget

Policy Prescriptions for the Economy

Kevin A. Hassett

Director of Economic Policy Studies

American Enterprise Institute

September 15, 2011

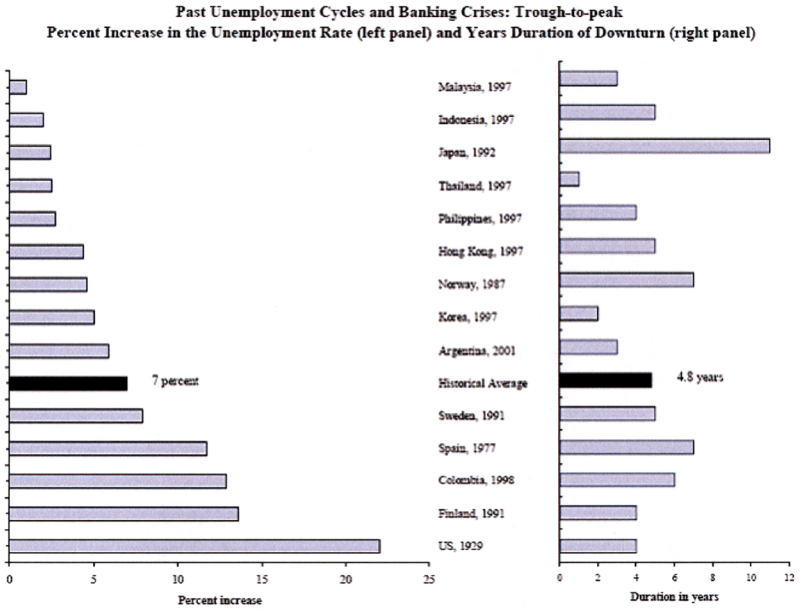
The views expressed in this testimony are those of the author alone and do not necessarily represent the views of the American Enterprise Institute.

Chairman Conrad, Ranking Member Sessions, and Members of the Committee, thank you for inviting me to appear today to discuss the state of the economy and the optimal policy prescriptions for the future.

Why has economic growth been slow?

Unfortunately, according to the latest indicators, the U.S. economy continues to disappoint and performs more poorly than original forecasts that were made by the more optimistic economists, who also tended to be supporters of the idea that our economy needs a big Keynesian stimulus. The weakness sadly does not come as a surprise to those of us who were convinced at the outset of this crisis that we would experience a nonstandard recession and recovery. We have known for some time that financial crises inevitably create lengthy periods of slow economic growth that are more pronounced than the slowdowns caused by typical recessions.

Figure 1:

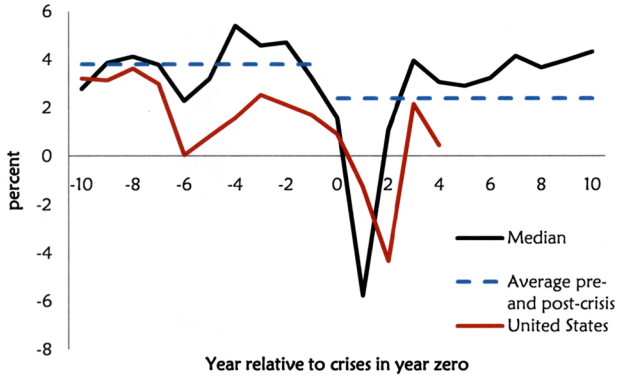


Economists Carmen Reinhart and Kenneth Rogoff have studied the history of financial crises and found that they are inevitably followed by lengthy periods of slow economic growth. In Figure 1, which is taken from their study, it can be seen that the typical duration of the employment downturn after a financial

crisis is 4.8 years. [1] Another study by Ms. Reinhart and her husband Vincent Reinhart found that economic growth rates tend to be lower for as much as a decade after the crisis.[2] I should add that their work, which is by far the most famous, is not the only that shows this connection, nor am I engaging in ex post theorizing. Back in early 2009 when I was testifying before the House Budget Committee, I made the same point drawing on work by economists at the IMF.[3]

Figure 2:

Growth of real GDP per capita
(Median experience around the 15 most severe financial crises of the second half of the 20th century)



Source: Author's Calculations from data provided by Vincent Reinhart.

Those of us who argued that the financial crisis history was the correct analogy for the current crisis were criticized throughout the debate by Keynesians as being too pessimistic. Yet, as Figure 2 shows, the U.S. economy has actually performed worse than even we, the pessimists, expected. There is no question that this disappointing growth is the result of policy error. Given that such a lengthy period of slow growth is the challenge, it was a mistake to address it with short term Keynesian stimulus.

While there is debate about the size of the multiplier effects of a Keynesian stimulus, let us assume, for the sake of argument, that they are substantial. Even then, every stimulus effort has not two but three stages. When the stimulus is imposed, there is some positive short-run increase in GDP. When the

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[1] Carmen M. Reinhart and Kenneth S. Rogoff, "The Aftermath of Financial Crisis." National Bureau of Economic Research Working Paper 14656 (2009). <www.nber.org/papers/w14656>

[2] Vincent Reinhart and Carmen M. Reinhart. "After the Fall." Paper presented at the Federal Reserve Bank of Kansas City Symposium, *Macroeconomic Challenges: The Decade Ahead,* Jackson Hole, WY, August 26-28, 2010.

[3] Kevin A. Hassett. "The Economic Outlook and Budget Challenges: A Testimony in front of the House Committee on the Budget." January 27,2009. <http://www.aei.org/docLib/20090217-HassettTestimony.pdf>
Claessens, Stinj, M. Ayhan Kose and Marco E. Terrones. "What Happens During Recessions, Crunches and Busts." *IMF Working Paper*, WP/08/274, December, 2008, http://www.aei.org/docLib/20081212_IMF.pdf.

stimulus is removed, there is an approximately equal and opposite reduction in GDP. But after that, the stimulus must be paid for with higher taxes or ongoing borrowing--causing a further reduction in GDP. The key observation is that the total impact of the Keynesian policy is negative in the long run.

A policy involving Keynesian stimulus might be defensible if the economy were in a typical recession, which can be expected to last on average about 11 months, and be followed by a recovery with sharply higher growth. Between World War II and 1990, the average rate of growth in gross domestic product (GDP) in the five quarters after a recession was 6.8%. In such a case, adding a percent or two of growth during the recession might well be worth having three percent growth instead of five percent growth in the recovery. But in the lengthy, slow-growth aftermath of a financial crisis, the hangovers arrive before growth has lifted off. Indeed, Keynesian stimulus in this circumstance will inevitably run the risk of tossing the economy back into recession even if one adopts the view that an increase in government spending will have a large positive effect on the economy. This is because the hangover will arrive when the economy is still weak.

Fears about the future

Recently, strong fears of a double dip recession have emerged in response to the slow economic growth of the past three years and the bleak outlook for the future. One particular focus of concern has been the level of indebtedness. Government debt commonly soars in the wake of a financial crisis, and skyrocketing debt-to-GDP ratios of many countries have triggered apprehension about future growth. This thinking is derived from a different set of work by economists Carmen M. Reinhart and Kenneth S. Rogoff.[4] In a widely-cited study, they document a strong relationship between high debt levels and slow growth, using data on forty-four countries spanning about two hundred years. Their main finding is that for developed countries, a gross debt-to-GDP level above 90 percent causes average growth to fall significantly.

Reinhart and Rogoff's work has received some criticism, for example that no evidence of causality is presented[5] or that their findings are unlikely to be relevant to the U.S. economy of today.[6] Also, their study only considers correlations between debt and growth and does not take into account other factors, as an IMF Working Paper by Manmohan S. Kumar and Jaejoon Woo points out.[7] Fortunately, these authors explore the issue further and extend the empirical work by Reinhart and Rogoff in useful directions. Their analysis controls for other growth determinants and takes into account estimation issues, such as reverse causality and endogeneity. The result suggests an inverse relationship between the initial debt level and subsequent growth – on average, a 10 percentage point increase in the initial debt-to-GDP ratio is associated with a slowdown in annual real per capita GDP growth of around 0.2

[4] Carmen M. Reinhart and Kenneth S. Rogoff, "Growth in a Time of Debt." National Bureau of Economic Research Working Paper 15639. January 2010. <http://www.nber.org/papers/w15639>

[5] John Irons and Josh Bivens, "Government Debt and Economic Growth: Overreaching Claims of Debt 'Threshold' Suffer from Theoretical and Empirical Flaws" Economic Policy Institute Briefing Paper #271. July 26, 2010. <http://www.epi.org/page/-/pdf/BP271.pdf>

[6] Yeva Nersisyan and L. Randall Wray, "Does Excessive Sovereign Debt Really Hurt Growth? A Critique of This Time is Different, by Reinhart and Rogoff." The Levy Economics Institute Working Paper 603 (2010)

[7] Manmohan S. Kumar and Jaejoon Woo, "Public Debt and Growth." IMF Working Paper WP/10/174. July 2010. <http://www.imf.org/external/pubs/ft/wp/2010/wp10174.pdf>

percentage points per year. Moreover, they also present evidence of nonlinearity with high levels of debt (above the 90 percent threshold established by Reinhart and Rogoff) having a significantly larger negative effect on growth.

Reinhart and Rogoff's conclusions are further supported by the recent work of Caner, Grennes and Koehler-Geib (2010).[8] They are mostly concerned with the existence of an identifiable threshold or a "tipping point." Moreover, they focus on the long-term effects and their data set includes 99 developed and developing countries. Their results establish a threshold of 77 percent public debt-to-GDP ratio. If public debt is above this threshold, each percentage point of debt costs 0.017 percentage points of annual real growth.

The results of these three studies suggest that the U.S. economy is indeed heading for unstable waters. The U.S. gross public debt to GDP has risen from 102 percent in 2010 to 109 percent in 2011 (based on the CBO data) and is predicted to reach 118 percent by 2021.[9] If the research by Reinhart and Rogoff is accurate, then the expected level of public debt in the United States would reduce expected growth in the U.S. by about half a percentage point per year over the next decade. The current CBO outlook does not incorporate this effect, but should. Adjusting downward for this calculation would increase the 10-year deficit projection by about 1.1 trillion dollars.

What can be done about the present situation?

The good news is that there is substantial reason to believe that there is a way out of this destructive Keynesian cycle of escalating debt. Over the past several decades many developed countries have undertaken fiscal adjustments in attempts to reduce high debt levels. These countries' restructurings had varying degrees of success and failure, both in reducing debt and in stimulating growth. Their experiences provide a lesson for the United States today.

The economics literature has focused on answering two main questions in this area: what aspects of fiscal consolidations produce lasting reductions in debt, and what aspects encourage macroeconomic expansion?

The answer to the first question is clear. Based on a review of the economics literature and analysis of 21 OECD countries, two of my colleagues and I recently found that cutting expenditures is more likely to produce a lasting reduction in debt than increasing revenues.[10] It is also typical that the more aggressively a country cuts expenditures, the more likely it is to successfully reduce debt in the long term. Averaging across a range of methodologies, the typical unsuccessful fiscal consolidation consisted of 53 percent tax increases and 47 percent spending cuts, as seen in Figure 3 below. The typical

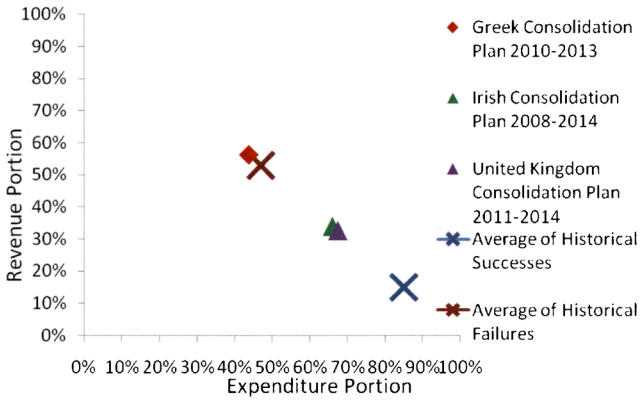
[8] Mehmet Caner, Thomas Grennes and Fritzi Koehler-Geib, "Finding the Tipping Point – When Sovereign Debt Turns Bad." May 19,2010. Available at SSRN: http://ssrn.com/abstract=1612407

[9] "The Budget and Economic Outlook: An Update." Congressional Budget Office. August 2011. <http://cbo.gov/ftpdocs/123xx/doc12316/08-24-BudgetEconUpdate.pdf>

[10] Andrew G. Biggs, Kevin A. Hassett, and Matthew Jensen, "A Guide for Deficit Reduction in the United States Based on Historical Consolidations That Worked," AEI Economic Policy Working Paper 2010-04 (2010) http://www.aei.org/paper/100179.

successful fiscal consolidation consisted of 85 percent spending cuts.[11] In particular, cuts to social transfers, largely entitlement spending and the government wage bill are more likely to reduce debt and deficits than cuts to other expenditures.

Figure 3:



Source: Andrew G. Biggs, Kevin A. Hassett, and Matthew Jensen. "A Guide for Deficit Reduction in the United States Based on Historical Consolidations That Worked." AEI Economic Policy Working Paper 2010-04. http://www.aei.org/paper/100179

There is more debate over the second question: what aspects of fiscal consolidation encourage macroeconomic expansion? The essence of the debate hinges on the balance between two economic effects of fiscal consolidation, the expectational effect and the Keynesian effect. The *expectational* effect is the positive effect on consumption and investment that occurs when policy is put on a sustainable path. These likely surge after a consolidation because of expectations of lower future tax liabilities and because of the elimination of uncertainty.

In other words, an immediate consolidation will alleviate the hoarding that accompanies fears of a larger and predominantly tax-driven consolidation in the future. Expenditure based consolidations would

[11] Many papers from the peer-reviewed literature confirm these results. Alesina and Perotti (1996) report that successful consolidations were 64 percent expenditure cuts and 37 percent revenue increases. Unsuccessful consolidations were 34 percent expenditure cuts and 66 percent revenue increases. Alesina and Ardagna (1998) report that successful consolidations were 62 percent expenditure cuts and 38 percent revenue increases. Unsuccessful consolidations were -79 percent expenditure cuts and 178 percent revenue increases. Alesina and Ardagna (2009) report that successful consolidations were 135 percent expenditure cuts and -35 percent revenue increases. Unsuccessful consolidations were 34 percent expenditure cuts and 66 percent revenue increases. Von Hagen and Strauch (2001) report that successful consolidations were 52 percent expenditure cuts and 48 percent revenue increases. Unsuccessful consolidations were 12 percent expenditure cuts and 88 percent revenue increases. Zaghini (1999) reports that successful consolidations were 77 percent expenditure cuts and 23 percent revenue increases. Unsuccessful consolidations were 2 percent expenditure cuts and 98 percent revenue increases. McDermott and Wescott (1996) found that expenditure based consolidations have a 41 percent chance of success; whereas revenue based consolidations have a 16 percent chance of success.

provide stronger expectational effects, because there is a better chance they are successful at reducing debt, and because higher near term taxes are hardly designed to ignite optimism in investors and consumers. The Keynesian effect reduces aggregate demand and therefore GDP growth. The controversy is over whether the expectational effects of fiscal consolidation can completely outweigh the Keynesian effects in order to create short-term growth.

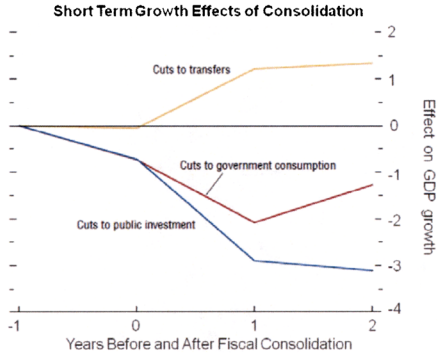
There is less controversy around the view that the long-term benefits of fiscal consolidation are substantial. Two schools of thought have emerged in the debate. Harvard economist Alberto Alesina and his various coauthors argue that consolidation, especially expenditure cuts, can lead to a burst of growth starting immediately.[12] A team of IMF economists, however, identified possible methodological flaws in Alesina's studies and claim that the typical fiscal consolidation would be contractionary.[13]

It is beyond the scope of this testimony to resolve the dispute between the two corners of the literature. A fiscal consolidation optimist would believe that the Alesina work is correct, and then would expect that a large fiscal consolidation in the U.S. would lead to significant positive growth effects even in the near term.

A pessimist would point to the alternative work of the IMF and argue that the growth effects of a typical fiscal consolidation are more uncertain. But it is important to note that even in this case, the IMF study points to positive growth effects if the fiscal consolidation is correctly designed. That is, both sides of the literature find that reducing expenditures will provide a better growth outcome than increasing revenues.

Although the IMF finds that a tax-based consolidation would reduce GDP by around 1.6 percentage points three years following implementation, they find that the negative effects of a spending-based consolidation would be small and statistically insignificant. That is, even in the most pessimistic corner of the fiscal consolidation literature, there is little to dissuade us from pursuing a consolidation today. Moreover, they find that spending-based consolidations that are focused primarily on transfer cuts could produce positive near-term growth effects.

The latter point is especially interesting since the authors study near-term cuts in entitlements. One might expect these to have



Note: Results based on a 5% of GDP Fiscal Consolidation where the expenditure cuts are primarily to transfers, government consumption, or public investment.
Source: International Monetary Fund. "Chapter 3: Will it Hurt? Macroeconomic Effects of Fiscal Consolidation," in *World Economic* Outlook. (IMF, October 2010).http://www.imf.org/external/pubs/ft/weo/2010/02/.

[12] Alberto Alesina and Silvia Ardagna, "Large Changes in Fiscal Policy: Taxes Versus Spending," *NBER Working Paper* w15438 (2009). Alberto Alesina and Silvia Ardagna, "Tales of Fiscal Adjustment," *Economic Policy*, Vol. 13, No. 27 (1998): 489-545. Alberto Alesina and Roberto Perotti, "Fiscal Adjustments in OECD Countries: Composition and Macroeconomic Effects," *NBER Working Paper* 5730 (1996).

[13] Daniel Leigh, Pete Devries, Charles Freedman, Jaime Guajardo, and Andrea Pescatori, "Will It Hurt? Macroeconomic Effects of Fiscal Consolidation," in *World Economic Outlook: Recovery, Risk, and Rebalancing.* (Washington, DC: International Monetary Fund, 2010).

a relatively large short-run negative effect on consumption behavior. The fact that expectational effects dominate even when entitlements are cut immediately suggests that out-of-control entitlement spending has a profoundly negative impact on forward-looking sentiment and business and consumer confidence.

This result also suggests a policy opportunity. Given the massive imbalances that exist today, it is likely that consumers have very little faith that current programs will remain in place throughout the course of their lifetimes. Accordingly, cuts to entitlements that phase in gradually over time will likely have little impact on their perceived lifetime wealth, as the benefit cuts are effectively already factored into consumer expectation. If consumers don't expect promised benefits to be paid, government can reduce promised benefits without causing today's consumption to go down.

Which means, of course, that the expectational effects of a fiscal consolidation would dominate and produce significant near-term growth if there are few immediate cuts to benefits but significant longer-term cuts. If, in addition, the fiscal consolidation were paired with a tax reform that broadened the tax base and reduced marginal tax rates, then a significant growth spurt would be the natural expectation to draw from the economic literature.

One way that we could easily cut fiscal outlays to provide an immediate boost to the economy would be to change the indexing formula for Social Security from wages to prices. A recent analysis by the Social Security Administration found that over a 75 year time horizon, this would improve the long run budget condition by $4.5 trillion in present value.[14]

Responding to President Obama's American Jobs Act

Having established what components a successful fiscal consolidation contains, and the principles that should guide policymakers at this crucial moment in history, I now turn to the proposal that the President has recently unveiled for boosting the performance of the economy. In the next section I will discuss a few additional proposals.

The headline observation to make about the President's proposal is that it mostly attempts to provide yet another short term stimulus, and thus, sadly, does not appear to be a reasoned response to the evidence that this recovery is consistent not with the typical postwar recession, but rather, with the typical post-financial-crisis recovery. Now is the time to address our big problems, not to ignore them and hope that a shot of economic adrenaline will save the day. Nevertheless, some of the proposals merit bipartisan support.

Let me turn to some of the major proposals, and discuss them in a bit more detail.

i) Payroll Tax Cut

There are two provisions of the President's proposal that relate to payroll tax cuts. One provision would cut the payroll tax in half to 3.1% for employers on the first $5 million in wages, providing broad tax relief to all businesses but targeting it to the 98 percent of firms with wages below this level. The employee side of this would likely provide a small positive near term consumption stimulus that would

[14] Social Security Administration. <http://ssa.gov/OACT/solvency/provisions_tr2008/charts/chart_run176.html>

be offset in an approximately equal and opposite manner when removed. This is, in other words, just a continuation of the policy approach that has lead us into this Keynesian downward spiral. The employer side of this would likely stimulate some hiring, as it seems unlikely that wages would adjust much to a near term temporary measure given the high unemployment rate.

The President is also proposing a full holiday on the 6.2% payroll tax firms pay for any growth in their payroll up to $50 million above the prior year, whether driven by new hires, increased wages or both. This is the kind of job creation measure that CBO has called the most effective of all tax cuts in supporting employment. This type of hiring subsidy would likely have a positive effect on hiring, and policies of this form have often been supported by conservatives in the past as an alternative to minimum wage legislation.

ii) Extension of expensing

Another proposal included in the President's American Jobs Act is the extension of temporary 100 percent bonus depreciation for certain business assets. Permanent expensing would likely be a part of any major tax reform that draws on lessons from the academic literature, and temporary expensing likely has a significantly larger near term effect on capital formation than permanent expensing.[15] Investment would certainly jump up for one year if this temporary measure were adopted, but it would jump back down the following year, and such a pattern is not the appropriate response to the policy challenge we face as a nation.

iii) Limit on Certain Itemized Deductions

The President's proposal outlines a 28 percent limitation on certain deductions and exclusions for individuals who earn more than $200,000 a year and families that earn more than $250,000. Most tax reform proposals argue for base broadening paired with tax rate reductions, and I view this proposal as a clever way to achieve base broadening. The problem with it is that it is not paired with permanent rate reductions, so it is a permanent tax hike that would make tax reform down the road much less likely, as revenue neutrality would be much harder to achieve. It is the height of folly to accept permanent harm in exchange for a near term "fix."

iv) Tax on Carried Interest

The provision in the American Jobs Act that calls for "special rules for partners providing investment management services to partnerships" is a particularly egregious case of punishing winners for their success and productivity. While the tax treatment of carried interest paid to fund managers may seem unusual, it actually follows from partnership tax principles that apply to industries throughout the economy. Internal Revenue Code (IRC) section 702(b) sets forth the general rule that partners are taxed on partnership income in the same manner "as if such item were realized directly from the source from which realized by the partnership." If a furniture store partnership, for example, realizes long-term capital gains or dividends, the partners who receive that income are taxed at the capital gains rate.

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[15] Hassett, Kevin A., and R. Glenn Hubbard "Tax Policy and Business Investment," *Handbook of Public Economics* Vol. III, Auerbach and Feldstein eds, Elsevier Science B.V., 2002.

Some critics are troubled by the fact that the carried-interest arrangement allocates part of the fund's capital gains and dividends to the managers when such income "belongs" to the investors who put up the money. It is not clear, of course, why the gains and dividends do not belong to the managers, whose labor helped produce this income. In any case, IRC section 704(a), a rule that also applies throughout the economy, permits the partnership agreement to allocate different items of partnership income and expense in any desired manner. If the furniture store partnership has two partners, one of whom works and the other of whom puts up the money, the partnership agreement may allocate any capital gains and dividends received by the store to the working partner, who would then be taxed at the 15 percent rate on that income. The provision in the Jobs Act is clearly intended to target managers who receive carried interest from hedge funds, private equity funds, and real estate firms, although it could also affect some other partners. Targeting the successful for special tax treatment is the worst way to incentivize success and productivity.

v) Work-Sharing

President Obama included a work-sharing proposal in his American Jobs Act, adopting a concept that is commonly used in Europe. Work-sharing is especially popular in Germany, where it is known as "Kurzarbeit" or "short work." That policy enables firms that face a temporary decrease in demand to avoid shedding employees by cutting hours instead. If hours and wages are reduced by 10 percent or more, the government pays workers 60 percent of their lost salary. This encourages firms to use across-the-board reductions of hours instead of layoffs. As a result, this policy has kept the unemployment rate in Germany from rising even though the country has seen a sharper decline in GDP than the United States.

The economic argument in favor of such a policy is powerful. When a recession strikes, firms are faced with a dilemma: sales and profits are down, and many workers are idle. But finding skilled workers is costly and time-consuming, involving large fixed costs. If a firm fires workers, it may incur large hiring and training costs when the recession ends and sales turn back up. Thus, a firm would prefer, all else equal, to hoard labor during a recession. Firms might well prefer to respond to a 20 percent cut in sales by reducing everyone's work by 20 percent. That way, employees remain part of the firm, and ramping up production is less costly down the road.

A number of factors discourage American firms from making that choice. The biggest is government policy. If a firm lays off workers, the government mails the unemployed a check. If the firm reduces work-hours, there is no government assistance, and employees are left to face the entire decrease in wages on their own.

A U.S. program based on Germany's would be attractive to firms, workers and taxpayers. It would subsidize firms as they hoard labor, enabling them to keep the best parts of their team even when sales dip. As the economy expands, firms will then be able to expand rapidly too, without sinking tons of time and resources into costly search.

Currently, 17 states utilize work-sharing in some form to make up part of employees' reduced wages. But few companies are participating because the government's contribution is not large enough to make work-sharing attractive. If the U.S. is to share in the labor-market success of its German friends, it needs a significant expansion of subsidies for work-sharing. Compared with the $787 billion economic stimulus, the costs would be low.

However, a work-sharing program should also be accompanied by a reduction in the duration of unemployment insurance benefits. Indeed, we would move toward a 21st century UI system if we built in automatic switches that significantly increase work sharing subsidies during recessions rather than extending UI benefit duration. The logic supporting this is sound. First, work sharing works, and it will be relied upon more if it is predictable. Second, workers have a harder time reconnecting to the workforce the longer they are unemployed, and unemployment spells clearly respond to lengthy duration of UI benefits. This view is supported by academic work by Alan Krueger, the President's new nominee to be chairman of the Council of Economic Advisers. In a study with Bruce D. Meyer for the National Bureau of Economic Research Working Paper series in 2002, Mr. Krueger examined the labor supply effects of social insurance programs. The author's empirical work found that unemployment insurance (UI) and workers' compensation (WC) insurance tend to increase the length of time employees spend out of work.[16]

There are those who say it is too late, but it is not. Even at this late stage, the potential benefits seem quite impressive. Every month there is a huge amount of churning with firms adding and subtracting millions of jobs. For July 2011 the Labor Department reported that 3.6 million private jobs were "destroyed," while about 3.7 million were created. The July data are typical. The net monthly job gain or loss conceals a huge amount of churning that produces this figure. This is an important policy opportunity, because there is already a massive amount of job creation out there. If we can slow job destruction even a little bit, then we will have set the stage for big increases in net job creation.

The Layoff Prevention Act of 2011 (S. 1333), which is intended to support the development and expansion of state work-sharing programs would likely have a significant positive effect on net job creation.

vi) Various Oil Provisions

The administration also seeks to acquire additional revenue through a number of measures designed to increase taxes on oil companies. These are analogous to the attempt to increase taxes on carried interest in that the changes target special treatment for an industry that is out of political favor. The oil measures appear to be motivated by an ongoing witch hunt against oil companies rather than any economic rationale. For example, the tax increase for "dual capacity" tax payers seeks to undo decades of legal precedent and disallow oil companies from receiving a credit against U.S. for a share of the taxes they pay to other countries. One recent study found that this seemingly punitive action would actually reduce U.S. tax revenue.[17]

Tax reform, a key component

As we consider ways to stimulate our stagnant economy, tax reform should be the primary target. It provides us some of the best—and most broadly agreed upon—opportunities to improve the health of

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[16] Alan B. Krueger and Bruce D. Meyer. "Labor Supply Effects of Social Insurance." National Bureau of Economic Research Working Paper 9014. June 2002. <http://www.nber.org/papers/w9014>

[17] Joseph R. Mason. "Budget Impasse Hinges on Confusion among Deficit Reduction, Tax Increase, and Tax Reform: An Economic Analysis of Dual Capacity and Section 199 Proposals for the U.S. Oil and Gas Industry." American Energy Alliance. July 12, 2011. <http://www.americanenergyalliance.org/wp-content/uploads/2011/07/2011-07-12-Mason-Oil-Tax-Deficit-Study-1.pdf>

the economy in the long run while also encouraging growth in the short run. That is, we get a growth effect without a hangover.

The complexity of our current tax code introduces a number of problems and inefficiencies. Through comprehensive tax reform, the system could be streamlined to improve taxpayers understanding (helping them make rational choices) and remove distortions that hamstring economic growth.

As we begin discussing tax reform, let's lay out the goals that any tax reform should aim to achieve. First, tax reform should improve incentives to invest; second, reform should reduce the corporate tax rate to increase international competitiveness. Third, the reform should smooth out variable treatment of different industries and assets while seeking to distort economic activity as little as possible. Fourth, the tax reform should improve incentives to work.

A reform that accomplished these objectives would accomplish exactly what we need to at this point in history. Just to sketch the terrain, a survey of 69 public finance economists conducted by Victor Fuchs, Alan Krueger, and James Poterba (1998) found that, at the median, respondents believed that the 1986 tax reform produced about one percentage point higher growth over a long period.[18] My review of the literature with Alan Auerbach suggested that this consensus is a fair reading of the broader tax reform literature.[19]

There are many possible reforms that would broaden and/or modify the base and then lower marginal rates. The key point is that they can conceivably have effects big enough to offset the growth shortfall that results from the financial crisis. Choosing to do another Keynesian stimulus instead of a tax reform at this juncture in history would be a horrendous choice.

The Case of the Corporate Tax

In the previous section, I argued that the case for reform could easily be made by highlighting the inefficiency of our current system. In this section, I provide another motivation for major surgery to the tax code: our corporate tax is now a worldwide outlier, and has become the economic equivalent of a ball and chain. If policymakers do not have the stomach for a big tax reform, they should at least reduce the corporate tax rate.

A study published in 2010 by the Organization for Economic Cooperation and Development (OECD) reviewed tax policy reform across OECD nations and listed recommendations based on that experience. The study concluded that, "The analysis suggests a tax and economic growth ranking order according to which corporate taxes are the most harmful type of tax for economic growth, followed by personal income taxes and then consumption taxes, with recurrent taxes on immovable property being the least harmful."[20]

Given this, and the general observation that fundamental reform would be most beneficial if we moved toward consumption taxation, I will digress and discuss in a little more detail the case for corporate tax reform specifically.

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[18] Victor R. Fuchs, Alan B. Krueger, and James M. Poterba, "Economists' Views about Parameters, Values, and Policy: Survey Results in Labor and Public Finance," *Journal of Economic Literature* 36 (3): 1387-1425.
[19] Alan J. Auerbach and Kevin A. Hassett, *Toward Fundamental Tax Reform*, (Washington, DC: AEI Press, 2005), 150.
[20] *OECD Tax Policy Studies: Tax Policy Reform and Economic Growth* (OECD Publishing, 2010), 10.

While there is broad consensus that the high statutory corporate tax rate in the U.S. makes investments in the U.S. uncompetitive relative to other OECD economies, some question the extent to which *effective* taxes paid by corporations are equally high. As there will be much discussion of these factors in coming months, I turn to providing some hard data. To skip to the conclusion, even if one looks at effective rates, the U.S. is in a bad spot.

The top national statutory corporate tax rates in 2010 among the 31 members of the OECD ranged from 8.5 percent in Switzerland and 12.5 percent in Ireland to 35 percent for the U.S.[21] Hence within the OECD countries, the U.S. has the highest statutory rate of taxation at the national level.

The picture changes only marginally when we add the sub-national corporate tax rates to the top national rate. In the case of the United States, the average top statutory rate imposed by states in 2010 added just over 4 percent (after accounting for the fact that state taxes are deducted from federal taxable income)—for a combined top statutory rate of 39.2 percent. Among all OECD countries in 2010, the United States' top statutory combined corporate tax rate was the second highest, after Japan's at 39.5 percent.

Top combined statutory rates amongst OECD countries have fallen from an average of about 48 percent in the early 1980s to 25.5 percent in 2010. The main wave of reforms occurred in the mid to late 1980s but has continued in the 1990s and through the 2000s. In fact, the OECD average fell almost 9 percent in the first decade of the 21st century. The United States, on the other hand, has not reduced its top statutory rate since 1993.

In 1981, the bulk of OECD countries had an average combined tax rate of slightly above 47 percent.[22] The U.S. rate was about 3 percentage points higher than that, at 50 percent. In 1996, the U.S. tax rate was close to the average for the bulk of OECD countries, at approximately 39 percent. However, in 2010, with no change in the top rate since the 1990s, the U.S. is now amongst only 4 other OECD countries that have tax rates above 30 percent. Thus, the competitive gap between U.S. and OECD corporate tax rates has opened up since the 1990s primarily because of widespread and substantial rate reductions abroad, rather than any significant corporate tax increase in the United States.

Many have argued that despite our high statutory corporate tax rate, loopholes cause the United States to collect relatively little revenue. In other words, even if the rate is 39.2 percent, firms pay far less than that. In truth, the U.S. ranks little better when looking at the effective rates than when looking at statutory rates.

Let's look at the effective average tax rate (EATR)—the difference between the pre-tax return and the post-tax return expressed as a fraction of pre-tax economic profits. The EATR computes, simply, a firm's tax liability as a fraction of pre-tax economic profits in country x. This rate differs from the statutory rate because it reflects the lower rate that the firm actually pays once we have included other features of the tax code such as depreciation allowances or interest rate deductions.

There are a few different ways to calculate the EATR, but in each case, the U.S. effective rates are uncompetitive. The World Bank, considering the effective rates, ranks the U.S. tax climate worse than all

[21] "OECD Tax Database," http://www.oecd.org/ctp/taxdatabase.
[22] "OECD Tax Database," http://www.oecd.org/ctp/taxdatabase.

but two industrialized countries for incorporation.[23] A 2010 paper by tax experts Kevin S. Markle and Douglas A. Shackelford also concludes that from 1988 to 2007, U.S. firms faced the second highest effective rates in the developed world.[24] And finally, my own research with my AEI colleague Aparna Mathur ranks the U.S. tax climate at second worst for locating investments in plants and machinery.[25]

The last argument I will offer for lowering the corporate tax rate is one of incidence. Recent research from a variety of studies shows that the brunt of the corporate tax rate is borne by workers as much or more than capital owners. This counterintuitive result comes because capital tends to flow from higher tax jurisdictions to lower ones. As this happens, workers are left with less capital and become less productive. The result is that they ultimately bear the incidence of the tax in the form of lower wages.

Recent empirical estimates of the share of the corporate income tax that falls to labor could potentially range from 75 to 100 percent.[26]. Given that huge burden on workers, lowering the corporate tax rate in the current economic condition could yield double benefits.

Summing Up

At this critical juncture in U.S. history, it is essential that we all work together to 1) accomplish a fiscal consolidation and 2) to accomplish a fundamental tax reform. A fiscal consolidation that pushed the U.S. debt level away from the danger zone could easily increase expected growth by about half a percentage point a year. A tax reform could provide an additional growth stimulus of at least the same scale. Combined, these policies would more than offset the growth handicap associated with the financial crisis.

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[23] World Bank Doing Business Report. http://www.doingbusiness.org/rankings

[24] Kevin S. Markle and Douglas A. Shackelford, "Cross-Country Comparisons of Corporate Income Taxes." http://resources.news.com.au/files/2010/05/24/1225870/574129-aus-tax-review-paper.pdf

[25] Kevin A. Hassett and Aparna Mathur. "Report Card on Effective Corporate Tax Rates," AEI *Tax Policy Outlook*, February 2011.

[26] See for example Hassett and Mathur (2010), Felix (2007), Desai et al (2007) and Arulampalam et al.(2008)

Chairman CONRAD. Very well. Thank you very much for your testimony.

Let me—Dr. Zandi, you have just heard Dr. Hassett. He has a somewhat different view. You know, it is interesting. There is a commonality here. I think everybody agrees we have got to have deficit and debt reduction over a ten-year period, that we cannot allow the debt to continue to grow. I think we have got commonality of view on that.

The difference that I hear is a question of timing. When do you start to impose the fiscal discipline? I hear, Dr. Zandi and Dr. Stone, you would put it off because of the weakness of the economy now. Dr. Hassett has a different view, that we should start right now. I do not want to misstate your view, Dr. Hassett, so speak up if I am misstating it, but that is what I have heard here.

On the other hand, everybody is saying there are things that you can do that would be effective right now. Dr, Zandi, you have said payroll tax relief ought to be high up on that agenda. Dr. Hassett has talked about tax reform, a tax reform agenda could provide an immediate boost.

So, Dr. Zandi, what of what Dr. Hassett has recommended would you most strongly agree with and what would you most strongly disagree with?

Dr. Zandi. And we are good friends. But I would—let me say a couple of things. First, I am not arguing that we should not have fiscal restraint now. I am just arguing it should not be as large as we have in current policy. I mentioned 1.7 percentage points in 2012. I am not arguing turn that all the way around and say add to growth. I am just saying, scale that back a bit given the current state of the economy. That is all I am saying. I think we should start now, just not to the degree that we are anticipating.

And I agree almost entirely with what Kevin said in terms of corporate tax reform. I know he is a large proponent of workshare for unemployment insurance. His focus on long-term fiscal issues, you know, I think it is very—I agree totally.

The one place I do not agree is that I do think providing some additional relief in the near term, like extending the payroll tax holiday for another year, would be very beneficial. He is absolutely right that when you get into 2013 and 2014, there is a payback. There is no free lunch. I am not arguing that. But I do think the—I am much more optimistic about our economy's fundamentals. I do not buy into the Rogoff-Reinhart view that we are going to be stuck in a malaise for ten years. That is a study based on experiences overseas in many periods of time, not our experience today. The United States economy is a very flexible one and we have righted a lot of the wrongs that got us into this mess.

Corporate balance sheets, non-financial U.S. businesses, have never, ever had as good a balance sheet as they have today. Their debt service burden is as low as it has ever been. The amount of cash they have on their balance sheet is as high as it has ever been. By any metric, businesses are in great shape.

The banking system has made significant progress, largely because of the policy response. The best policy response was to ask them to go through stress tests and raise a boatload of capital, and TARP allowed them to do that because they were backstopped by

the Federal bailout fund, which, by the way, has generated revenue for taxpayers. So the banking system in aggregate is well capitalized and rock solid and can lend and is lending. If you look at credit growth, it is growing.

Households have some more work to do, but just a statistic to give you a sense of how much work they have done. Household debt has fallen by $1.2 trillion since the peak. The peak was precisely three years ago, August of 2008. That is a ten percent reduction. So the debt service, the portion of income that is going to servicing debt by households, is nearly a record low and falling rapidly, and you can see it in the credit statistics. If you look at delinquency rates on credit cards, auto loans, consumer finance loans, pretty much across the board, except for first mortgage, where we have still got problems, and we can talk about that, it is back to pre-recession levels.

So I do not believe the U.S. economy is in store for ten years of going nowhere. We are not. So I do think we need to get through the next 12 to 18 months. And on the other side of that, I think our prospects are bright. But if we go back into a recession now, then all these things that we are—all the problems with the balance sheet that Rogoff and Reinhart are worried about, that Kevin is worried about, we will just be swamped by them. So we need—we should provide this additional support to the economy in the near term.

Chairman CONRAD. All right.

Dr. Stone, what have you heard here that you most strongly agree with and most strongly disagree with?

Dr. STONE. Well, what I heard that I most strongly agree with right now is, going to Dr. Zandi first, is that we do need support for the economy right now to fill in some of that gap between what we are producing and what we are capable of producing.

And with respect to the payback part of the argument, what payback means is that you do not permanently boost the recovery path above what it would be, but you fill in some of the gap right now when you really need it. And a couple of years from now when the fiscal impulse is starting to phase out, the economy is at a higher level of GDP.

CBO estimates that we will lose about $2.5 trillion of output that we do not produce, jobs we do not have, income that is not generated, before we get back to full employment. The support that we provide now can offset some of that loss. The loss from an output gap is lost forever and the human hardship that goes with it is there forever.

What I—I do not disagree at all with the notion of corporate tax reform and things like that as part of a longer-term strategy to deal with our long-term growth prospects. I am not sure that they are going to be very helpful in the short run of supporting the economy.

And finally, just on the question of what the International Monetary Fund says about this fiscal austerity, they just produced a report, a summary of their findings. Their conclusion—I mean, Kevin is right that the research shows that spending-based deficit reduction across a wide variety of situations in different countries at dif-

ferent times does tend to produce smaller losses to the economy than tax-based deficit reduction in those countries.

But under current U.S. economic conditions and under the conditions in Europe right now, the IMF does not find that to be true. What they say in their latest report is evidence from data over the past 30 years shows that consolidation lowers income in the short term with wage earners taking more of a hit than others. It also raises unemployment, particularly long-term unemployment. It does not distinguish between tax-based and spending-based.

Chairman CONRAD. Okay. I thank you for that. My time has expired.

We are going to go to Senator Sessions and then we will——

Senator SESSIONS. Get Mr. Hassett to respond.

Chairman CONRAD. Well, my—if you want to give me the additional time, I would be happy to do that.

Senator SESSIONS. I guess he started it, right, so you gave the others a chance to respond——

Chairman CONRAD. Well, I ran out of time, and he is your witness, so——

Senator SESSIONS. Okay. Thank you.

Dr. Zandi, you looked at the Rogoff-Reinhart study and to be careful about the question of growth and public debt, and their study was based on an empirical analysis of failed states' sovereign debt problems that arose from increasing debt, and it was a gross debt figure that they used. So we are not at 90 percent. We are at 100 percent now in the United States of gross debt, and I think it is dangerous, Dr. Stone and Dr. Zandi, to say that somehow these circumstances do not apply to us, because I recall the name of their book.

The name of their book was, This Time Is Different. And what they meant by that title was that when nations got in these fixes, they went into denial and always said, well, maybe that applied to other countries, but it is different in our country. And I am just afraid that we are at a point where our debt, as we have been warned for a number of years, is putting our economy at risk.

So, Dr. Hassett, I would like maybe to give you a chance to respond to the previous comments that have been made, number one, and number two, would you opine as to whether or not the debt itself is placing the economy at risk now, the level that we are at. I mean, I just do not think if—I think we have gotten to the point where the debt is so high that we have got to talk about it, Dr. Zandi. We cannot not debate your theory that we need to borrow money, more money, as a part of a debt limit or a new budget for next year or a spending level for next year. It has just got to be part of the debate. And if our economy is so fragile we cannot debate it, why is it so fragile? I think it is the debt that has made it this fragile, would be my—but, excuse me. Dr. Hassett, I would yield to you for comments on these matters.

Dr. HASSETT. Thank you, Senator Sessions, and for the opportunity to respond to the responses to me. The one thing I can say is that, on the debt question, so I will go to the last one first, is that in addition to the Reinhart-Rogoff study, there has been a kind of explosion of analysis in this area, some of it extraordinarily sophisticated and interesting to math geeks like myself who like

what they call non-linear time series models because it is a very challenging thing to estimate.

But after looking through the literature, I am just really convinced that there is a very powerful result there, that enough different people have looked at it with different types of models and so on, that we are in an absolute danger zone where we can expect not a sudden collapse, but slower growth by maybe a half a percent a year for a good long time if we do not start moving back to where I know Chairman Conrad in the past had proposals that would have taken us into the safety zone.

Senator SESSIONS. Well, could I——

Dr. HASSETT. So we absolutely need to do something, yes.

Senator SESSIONS. The Rogoff-Reinhart study said one to two percent growth when you reach that level, so——

Dr. HASSETT. The question is just in terms of, like, how big the result is. First, there are different estimates. But also, it is, like, how far you are from the threshold and for how long. And so if you are one-and-a half times GDP and the threshold is 80 percent of GDP, then you are really far and you will get a bigger growth effect than if you are just a smidgen above 80 percent of GDP. And as debt grows, then this growth effect gets worse and worse. And so if we do not fix the problem, then, absolutely, we are talking one or two percent growth off of where we are 15 years from now absent a fiscal consolidation.

But on the near-term question, first, I absolutely—you have to stipulate that if we were to cut the payroll tax for a year, then GDP in that year would probably go up some. I do not know how many jobs you would create because there is a lot of labor hoarding going on. You would definitely get some GDP out of the consumption of that.

But I think that the point of my testimony, and it is something that I would urge every member of this committee and every member of the Congress to think, is that I need to know when I am doing one of these temporary stimuluses, or stimuli, that not only that now is a good time to go up, but when I take it off, that is a good time to go down.

And so if you are confident that Dr. Zandi is correct, so he is absolutely, totally internally consistent in his analysis because he does not really believe that the financial crisis is the right guide and he thinks that the down is going to happen in a period where we can afford the down, then if you are willing to accept that view and ignore the history of financial crisis, then you should be with the President on his stimulus plan, that you would probably get more GDP this year.

But I am not willing to accept that, and I think that, again, Dr. Zandi mentioned corporate tax reform. But I think that we are in the boat right now where we are essentially saying, sure, we offer U.S. corporations a chance to avoid U.S. tax by moving their operations overseas, transferring their intellectual property overseas, increasing their employment overseas. If they do that, then they have perhaps one of the lower tax rates on earth. If they do anything here in the U.S., like build a new plant that is going to create jobs, then we charge them about the highest corporate tax on

earth, the second highest corporate tax on earth. That is a real deep permanent obstruction to job creation here in the U.S.

And the idea that we can ignore that and that if we have a one-year payroll tax, it is going to be great, is something that we just need to reject and reject with emotion, because we have to stop ignoring our big problems. So we are not going to get job creation in the United States if we keep ignoring them. And if we spend a lot of money, another $400, $500, $600 billion on these temporary stimuluses, then what is going to happen is we will not have the money to fix the corporate tax in a way where people will want to locate jobs here again, and that is why I feel so strongly that we should not do it.

But I absolutely do not want you to think that I believe that GDP will go down if we have, say, a payroll tax cut, because I do not think that that is true, at least not for this year.

Senator SESSIONS. Could I ask each of you if you can just—yes or no would be good—do you agree that actions to increase economic growth without increasing the debt would be a preferable activity for the United States insofar as that is achievable?

Dr. ZANDI. Absolutely.

Senator SESSIONS. The three of you agree with that.

The second question: Do you agree that eliminating costly regulations that can be shown not to produce beneficial results would create—and that creating a more growth-oriented Tax Code and producing more American energy would be good for the economy?

Dr. ZANDI. Absolutely.

Senator SESSIONS. All three agree with that?

If our Nation was able to substitute imported oil with American production, would national income rise?

Dr. ZANDI. Yes.

Senator SESSIONS. Well, I think those are some things that we ought to be focusing on very intensely. The President has not moved in those areas yet, although his recent speech indicated he might be more open to it, and I would encourage all of us to focus on those matters rather than primarily focusing on more debt-enhancing proposals.

Dr. Zandi, the total debt package that the Committee is asked to achieve is $2.4 trillion over 10. You favored $4 trillion over 10. And do you think that $2.4 trillion is simply not enough?

Dr. ZANDI. I do not think $2.4 trillion is enough, no. I think we need—if you do the arithmetic, I think there is general consensus that we need $4 trillion in 10-year deficit reduction. That $2.4 trillion is not enough, no.

Senator SESSIONS. Thank you.

I am inclined to view that more is needed, but we have had a lot of people say that $4 trillion is the bottom-line figure, as you and your Debt Commission found. Thank you.

Chairman CONRAD. I thank the Senator for asking that question. I actually tried, I personally tried to convince the Fiscal Commission to do $6 trillion because I wanted to balance the budget in 10 years. And we could do it. I mean, I proposed what I called "the 6-percent solution." If you have 6 percent more revenue than is forecasted over the next 10 years, not by raising marginal rates—I agree entirely with Dr. Zandi. I think Dr. Hassett probably agrees

with this. I think Chad probably does as well. Increasing marginal rates is not a good idea, but tax reform is a good idea. If we raised revenue from what was otherwise anticipated, 6 percent, cut expenditures from what is baked in by 6 percent, we would get $6 trillion of deficit and debt reduction over 10 years.

You know, somehow we have got it in our heads that this requires some radical change. It is not. It is relatively modest changes to where we are headed to get us back on track. And I am very glad you asked that question.

Senator SESSIONS. You know, I would just observe to the economists that we are a political institution. We cannot always receive a phone call from an economist and change the Tax Code tomorrow or reduce spending or increase spending on a dime. And I think there is a fundamental opportunity right now based on my reading of the American people that they will accept serious reform of spending, and even if it is not the precise exact time that it ought to occur economically based on various opinions, I think we had better seize the opportunity while we have a chance.

Chairman CONRAD. Thanks, Senator.

Senator Begich, and then it will be Senator Nelson and then—wait a minute. I have got here that Whitehouse was next.

Okay. Senator Begich and then Senator Ayotte next.

Senator BEGICH. Thank you very much, Mr. Chairman, and I always find—and I know we have had at this meeting and others economists. I always find it interesting to listen to economists and their analysis of what could happen and what will not happen. Three years from now we will have the same discussion of what did happen and who was right and who was wrong. And no one is going to be right 100 percent, no one is going to be wrong 100 percent. That is what we will find in this analysis here. So let me just do some kind of just basic questions.

First, if I could ask all three of you a very short—I think one of the problems is the inability—well, let me put it another way. Even though Congress is viewed by the American people—I think we are at a robust 13-percent popularity, and maybe going the other direction. They still look toward Congress to figure out what policies are going to be developed to determine kind of where they are going, even though they may not like us today. By us doing these kind of short-term skip-and-hops, no real long term, doesn't that have some effect in the economy? Does anyone—I mean, the uncertainty of our inability to do anything here, we have no ability to think—like, we are about to do a highway bill and an FAA bill for a robust 6 months. That should give a lot of comfort to the contracting community to go out and buy new equipment to get ready, because in December—or February of next year, they will find out if we are going to really do a road project bill. Give me your thoughts on that. I would like you to keep them short only because I have got several questions I want to——

Dr. ZANDI. I concur with your view. I think there are some immediate problems that need to be addressed, and that is the economy's difficulty currently, the prospects for recession. But I do think also that it is very key for policymakers to look longer-run. We have got a lot of long term problems. And by doing that, you provide more clarity, more certainty with respect to policy, and that

is very, very important to decision making today. Businesses do not think about 6 months or 12 months. They think about 5 years; if they are an electric utility, 30 years. So you need clarity and certainty.

Senator BEGICH. Dr. Stone.

Dr. STONE. Agreed. There are crises and you have to deal with them, but you should have a long-term plan.

Senator BEGICH. Dr. Hassett.

Dr. HASSETT. Thank you. The evidence is quite strong that especially for big capital projects with long lives, this uncertainty is very big. And that also provides something of a marker for us as we think about the Fiscal Commission, because if they sort of promise future cuts but we do not really know if they are going to happen, then we will not do much to accomplish—to reduce the uncertainty. But if they, you know, have specific proposals and maybe adjustments to entitlements and so on and they are really credible, then we could get a big surge in business optimism. And businesses have so much cash right now that if they get optimistic, we could really see a lift-off.

Senator BEGICH. You just hit on my other piece. First let me just say why I wanted you to answer this, because I know in the political arena we live in here, you know, we will blame the President for a variety of things because we do not want to take our own responsibility. And the responsibility we have as Congress is to actually do something, actually make some decisions that are not going to be easy. A good example is the highway bill, this FAA bill, which are thousands and thousands of jobs that are sitting on the line. Because we differ over one or two items, we are going to throw the whole thing out because we think that is best for the political fight rather than the economic issues. And why I am saying this is more of speaking to the choir here because you agree, but also to the people who are watching that we have a responsibility here as Congress. It is not just the President. It is all of us that actually have to do something. So I just want to put that on the table.

But, second, Dr. Hassett, you said it and I am a believer in this, and that is, if we are positive and we have a positive attitude, a lot of things can happen. When we sit around—if you came to work every day and your boss always said the sky is falling, guess what? You will believe that, even though it may be factual or not, it is irrelevant. At a certain point you are not very comfortable working in that environment, and you feel very bad about the situation.

We have a habit here—and the press accompanies us in this effort—if it is negative, we are the first to speak out on it and it gets the front headlines. When we talk about the policies, like this last month—and I think it was third consecutive month our trade deficit decreased, but it was this big in the Washington Post I think, you know, on page 14 or something, buried. I think that is positive. I think the 2 million jobs we have created over the last—when I say "we," collectively in this economy, since 2009 is pretty good because we are not in the negative spiral, which is what we were when I came here. We were 500,000 jobs lost in a month. We are in a positive. The market is up 70 percent since January 2009. There is more cash in the banks of businesses all across this country than ever—I do not want to say in history—in history. I will

take your word on it. This is significant, but we do not talk about that. Or the bank bailout bill, which I was no big fan of, but it has actually produced a positive revenue stream to our country. They paid it back plus more.

The auto industry is at the highest—every single one is showing profit since 1998 for the first time. I do not know. I think that is good news. Maybe I am wrong, but that seems to be good news.

But we tend to talk about the negative so that people fear what is going to happen. So we have a responsibility to talk about what is good, what is positive, what is going on in this economy that can help people's attitude, because I believe in two statistics that are important: consumer confidence and retail sales. I know unemployment, GDP, and all that—when I go back home and I mention GDP, people look at me like, "What are you talking about?" When I say "consumer confidence" and "retail sales," why? If the consumer is confident about the economy and feels good about where we are going, they will spend more money. When they spend more money, they spend it in retail areas, which are the highest taxpayers in corporate America because they do not get all the fancy breaks. They do not get all the—I know this. We are in the retail business in our family. They pay the highest rate. But they are also the fastest to reinvest in equipment and employees.

So I just—I went on a little rant here because I get a little frustrated when people—everything is bad news. Well, you want to talk bad news? It is kind of like in the Snoopy cartoon. Sooner or later the person who has the cloud over their head, it is all bad. We have a choice to make here.

But here is one that—it is one of the President's proposals, and I know at times Republicans have supported this and Democrats. It has gone both ways, but it depends on the political winds of the day. But the 6.2-percent payroll tax for employers to receive from a retailer, a small retailer, maybe they are making, you know, half a million, three-quarters of a million gross income in a year. For a $30,000 employee to receive that $1,800 benefit, they have got to sell probably $75,000 or more worth of goods. I understand the employee's standpoint because they will take that money and spend it. But the employer, they are looking for business. If they have to now figure out how to generated $75,000 worth of business to get an $1,800 benefit, help me understand why that is a good thing. And maybe you do not agree it is a good thing, but that is one of the proposals. The employee part I am all—I think it is a good—you know, more money in the employee's hands, the faster they will spend it and use it to do whatever they want to do.

Dr. ZANDI. Sure. Do you want me to take a crack at it? Okay. Well, I sympathize with your perspective. I think the payroll holiday for employees is measurably more efficacious, effective, because it goes to your point.

Senator BEGICH. They spend it.

Dr. ZANDI. They spend it. The idea behind providing a benefit to employers is it is good for small businesses. When we talk about businesses—and I have been talking about their balance sheet and all the cash—it is important to make a distinction between small business and big business. The big guys and the medium-sized companies, you know, companies that employ over 200, 250 peo-

ple—that would be kind of a good demarcation—are doing very, very well, in large part because they are globally oriented, they can manage their balance sheet well.

Small businesses are struggling, and they have had trouble getting credit, and they have cash flow issues. So the idea here is that this would provide a boost to cash flow in the immediate near future. But again, you know, as you can tell, I am much more sympathetic—and on the margin it will be helpful. To Kevin's point, it will be helpful. But I think it is much more effective to focus on the employee side as opposed to the employer side.

Senator BEGICH. Good. My time has expired, so if someone wants to say yea or nay, then I can close there.

Dr. HASSETT. I will talk until the Chairman cuts me off. The one thing I want to say is do not forget—and it is also the argument for the work-sharing proposal of the President. This is one of the parts that I like. Underneath the sort of net of, oh, 50,000 job creation is a typical monthly flow of maybe 3.5 million jobs created and 3.4 million jobs destroyed or something. That is about what those numbers are right now. So there are people hiring right now all around the country. It is just that the net is not what we would like it to be. And so if we make it cheaper for employers to hire someone, then the people who are hiring might hire a few extra people, and that would be the motivation for that side of it.

Senator BEGICH. Thank you very much. There was your point by the Chairman. You were buying the time. Very good. [Laughter.]

Later on, tax reform, which I love.

Chairman CONRAD. Senator Ayotte.

Senator AYOTTE. Thank you, Mr. Chairman. and I want to say this is my first meeting of the Budget Committee, and I am hopeful that as we go forward into the new fiscal year that we will get together as a Committee to put together a budget for our country, because I think that is the responsibility that this Committee has. And as we look forward to the next fiscal year, I hope we have many more meetings and we make the difficult choices that have to be made when you actually have to sit down and put together a budget, a fiscal blueprint for our country, like so many of our businesses have to do, and our families.

I wanted to ask about—Dr. Zandi, you said there is no free lunch, and I could not agree with you more. Can all of the panelists comment on the impact of an increase in interest rates? Because our historically low interest rates right now, they cannot last forever. And, obviously, the Fed has made a statement that they are going to keep rates low over—it was a pretty significant statement that the Federal Reserve made in terms of what it would do with interest rates, but this cannot last forever.

One of the things I am concerned about is if we have even a 1-percent rise in interest rate, can you all describe for us what will happen in terms of the costs that we have to pay to service our debt? And the concern I have with it is we have a hard time around here saying we even want to cut $60 billion. Can you tell us what will happen when interest rates rise in terms of what we owe and what we have to repay?

Dr. HASSETT. Go in order.

Dr. ZANDI. You want me to go? Go ahead.

Dr. HASSETT. Larry Lindsey has done an analysis of this which is pretty chilling and suggests that if interest rates return to even a little bit towards normal, it could offset all the work that we do.

In fact, you know, probably in this Committee room no one has ever quite said these words before, but there is a very good write-up of this at ESPN, because the Tuesday morning quarterback for some reason, because he writes about whatever is spent, five or six paragraphs on Lindsey's report, and so you could Google that when you get back. But Larry Lindsey has done this analysis quite precisely, and the numbers are chilling.

Dr. STONE. Well, I will say something that might seem counter-intuitive, but actually if interest rates start to rise a little bit from their very low levels right now, that is probably a good sign because it probably means that the economy is getting stronger. One of the main reasons why interest rates are so low now is that the economy is so weak.

Now, it is also possible that we can have a bad situation in which the debt problems do become such that interest rates start to rise. That seems much less likely over the next few years than the opposite, which is that the economy remains weak and interest rates remain low.

Dr. ZANDI. I think that the impact of rising interest rates will be mitigated in part by the fact that many households are locking in these low rates. So if you look at total household debt outstanding, 85 percent, approximately, is fixed rate—most of it fixed-rate mortgages. And in this refinancing activity that is occurring now, very little is adjustable rate. It is all fixed rate. Businesses are also very good and being very aggressive about locking in these low rates.

The banking system is a little bit more at risk. They can get mismatched pretty quickly. But this is the number one concern at the OCC, FDIC, and regulators. They are trying to manage that as potential risk.

In terms of the impact on the fiscal situation, that is an issue. That will be a problem. But I would agree with Chad that if rates are rising, that is probably a good sign that the economy is improving and that we are generating more revenue and the automatic stabilizers are coming in. But it is an issue and one of the reasons to be concerned about taking on debt, because there is an interest bill to pay in the future and interest rates are not always going to be 2 percent on a 10-year Treasury bond.

Dr. HASSETT. Can I take a second——

Senator AYOTTE. Yes, please, Dr. Hassett.

Dr. HASSETT. Thank you. There are two ways the interest rate could go up. One is all of a sudden we start growing like hotcakes and everybody gets optimistic again, and then interest rates will start to go up, too. But the other thing that could happen is that people could decide that the United States is going to be insolvent and they do not want to buy Treasurys anymore, and then interest rates would go up. And how we should think about the economic impact of the two things would depend on which scenario we are in. And I think that we cannot be sure that the sort of run against the U.S. is something that we should discount completely.

Senator AYOTTE. You also talked about—Dr. Zandi, I believe you talked about it, as well as Dr. Hassett—our corporate rate and the

impact that has on decisions that the private sector makes. As I understand it, U.S. companies are sitting on a record $897 billion in cash, which is up 50 percent from 18 months ago. I would like you to comment on two things.

Mr. Zandi, you said at the top of your list was corporate tax reform. Why wouldn't we undertake that now? And, second how does repatriation fit in with corporate tax reform in terms of bringing that money back here to the USA?

Dr. ZANDI. I think you should do corporate tax reform right now. I think there is no reason that you should not pursue this, and I think there is a lot of common ground that we can find and we can come up with good legislation to broaden the tax base, generate enough revenue, hopefully to lower marginal rates and even perhaps contribute to deficit reduction. I think all those things can be done in the context of corporate tax reform.

I do think repatriation should be part of corporate tax reform. I think that one aspect of reform is changing to a territorial system, and as part of that process, we should use the cash sitting overseas as a mechanism for facilitating the process to get reform, because as Senator Sessions pointed out, this is politics and there is going to be a lot of vested interests. Every loophole in the Tax Code has someone who is willing to go to the mat for it, and we need some carrots to be able to get everyone on board. So I think I would use that cash in the context of the reform to make it all work in a political sense.

I do not think—just as another point of interest, there is some effort to bring the money home, allow for repatriation as a stimulus to the economy, bring that cash over here, somehow this would be beneficial to investment and hiring. I do not think that would be particularly efficacious, going to the point that cash is not a problem for these large multinational corporations. They have plenty of cash, and I do not think that is the constraint on their investment and hiring today.

Senator AYOTTE. I come from a small business family. I have been traveling around our State. I have asked all of our businesses that I have been meeting in August, What is the number one thing that we could do to help you and that you are most concerned about in terms of hiring, expansion? Regulations has been on the top of every single answer. In all of your economic analyses, have you taken into account the costs, direct and indirect, of regulatory policies from Washington on the private sector?

Dr. HASSETT. There are estimates of what the true cost of Government is that include costs of regulation that are pretty high. Afterwards I could communicate with you and send you some studies. I forget the exact number, but it is something like $1 trillion a year, costs from excessive regulations.

Dr. STONE. On the question of regulation, that is always a concern of small businesses, as are taxes. But I believe that the surveys of small businesses show that the number one concern for them right now is weak sales, and so I think we need to do something about that as well.

Dr. ZANDI. I just want you to know, I was a small business owner. I started my own company. I grew it into a small business of 125 employees, and I sold it to the Moody's Corporation 5 years

ago. So I have been an entrepreneur, a small business owner. I have created jobs. And regulation is a problem. Particularly what is the biggest problem is changing regulation. I can live with, as a small business owner, anything that you think is necessary, as long as I have clarity with respect to what that is. Then I can plan and I can adjust. It is when the regulatory environment is changing quickly that it creates a lot of uncertainty. I cannot plan for that, and that is a problem.

So I think regulatory burden is an issue. I think it needs clearly to be addressed, but most importantly, we need clarity and certainty with respect to the regulatory environment.

Senator AYOTTE. Thank you very much.

Chairman CONRAD. Thank you, Senator.

Senator Nelson.

Senator NELSON. Good morning, gentlemen. In the President's jobs package, he is proposing that we limit the value of itemizing deductions for upper-income taxpayers. And so I would like to have your view what effect this would have on the economy, and if you do not like that, tell me what might be another way to do it.

Dr. ZANDI. I think that this is a reasonable approach to deficit reduction. In my view, we need $4 trillion, 10 year deficit reduction. I think the preponderance of that should be spending cuts. But I do think we need tax revenue as well, additional tax revenue. And to generate that revenue, I think we need to scale back the cost of the deductions and credits, the so-called loopholes in the Tax Code. And the approach that the President has proposed in limiting the ability of higher-income households to use deductions and credits in the Tax Code is a reasonable approach to that end. So I think that should be part of the process, yes.

Dr. STONE. I agree. It is part of longer-term tax reform and to pay for the stimulus. I believe the Bowles-Simpson Commission recommended get rid of the loopholes and then have Congress decide what ones they wanted to put back in. There is a lot of money in tax deductions. There is a lot of political support for those tax deductions. So it is not saying it is easy, but it is a good approach.

Dr. HASSETT. It is actually a clever way to broaden the base. My concern, as I mentioned in my testimony, is that it should be part of a comprehensive tax reform, not a one-off to pay for a temporary stimulus. But I think that the basic idea is a sound one because it kind of takes a lot of sacred cows off the table collectively.

The one thing I would note is a lot of people have not noticed that there are some above-the-line things in the President's proposal like municipal bond interest and health insurance that would see tax hikes as well, and so if we think through the total economic impact of that in isolation, one would want to account for, for example, the potential right now that strapped municipalities might have a problem if they lost the tax-favored status of their muni bonds.

Thank you.

Senator NELSON. Well, I am one member of this Committee that agrees with the Chairman—and I thank him for all the work that he did on the Gang of Six and before that Bowles-Simpson—that this is a moment in time that we could get major tax reform because with the discipline enforced through the process of this Super

Committee, and then with an up-or-down vote required before Christmas by each House, we really could get something done.

Now, the question is: How do you go about getting rid of the loopholes? Do you take a percentage of the loopholes and say, as the Chairman had suggested? He was saying 10, 15 percent if you eliminated $14 trillion of loopholes over 10 years, that is some real money. So round it, say, to $2 trillion over 10 years, take that money, pour it into the Tax Code, simplify the Tax Code, lower the rates, that is real reform. Or I want to try on you a suggestion of Martin Feldstein the other day in our hearing in which he says, well, do not touch the loopholes, the tax expenditures, but put a certain percentage on each individual taxpayer of the total amount that they could deduct. He was suggesting 2 percent, but it could be 5 percent. A 2-percent deduction on each taxpayer of the total amount of loopholes that they could utilize he says would bring in $3 trillion over 10 years. What do you think about that?

Dr. ZANDI. I think that is a very clever and laudable approach. I mean, he wrote a very nice paper, oh, almost a year ago kind of going through the arithmetic and the math and it was very compelling to me. So I think that is a reasonable approach to this problem.

Dr. STONE. It is clever. Sometimes we economists get criticized for our clever ideas, that they are too clever by half, but it is a way to deal with the issue.

I would like to say something about tax reform, which is tax reform is important. It is important for long-term growth. But we are talking about deficit reduction and so we cannot talk about tax reform that ignores the fact that it can be a way of generating revenue, and we are going to need a lot of revenue to reach $2, $4, $6 trillion of deficit reduction.

Senator NELSON. Well, let me point out on that, before I get to you, Dr. Hassett, the Chairman pointed out that if you took his idea of 15 percent of all of the $14 trillion of tax deductions and you poured that into the tax code and you did it on a revenue-neutral basis, so in other words the money that you save, say it is $2 trillion, you are pouring it in over here. You are reducing tax rates by $2 trillion.

What the Chairman points out, his staff, is that a simple tax code simplified, getting rid of some of the inefficiencies of the existing tax expenditures, that through growth over the next decade, it actually earns you a new $1 trillion in tax revenues. What do you think about that?

Dr. HASSETT. Well, I will—since I was about to go anyway—and I agree that this—if you just eliminated the tax expenditures and then had across-the-board proportional rate reductions, I think you would get the top rate down into the low 20s. So that means that there is a lot of room.

Now, some things that we call loopholes are things that are there for a sound economic reason. You do not want a small business to be taxed on revenues. You want them taxed on profits. That means you have to subtract some stuff, right. But the basic principle is sound and I agree that if we did that, then we would probably get a lot more revenue than Joint Tax would credit us with.

Senator NELSON. Would Martin Feldstein's idea of a limit on individual taxpayers—and I assume you could do that on corporations, as well—would that create the circumstances by which you would have growth and therefore new revenues from growth over the next decade?

Dr. ZANDI. Yes. Yes, I think that would be an approach that would generate the kind of benefits that you are talking about. Yes, I think that would be the case. I do think, though, that we need to stick to that goal of $4 trillion and ten-year deficit reduction. We have got to do that.

Dr. STONE. Yes, there will be some growth effects, but let us not exaggerate or let us not be overly optimistic about how big the effects we can get. That would be counting on things that might not come and could short circuit the deficit reduction we are trying for.

Senator NELSON. Thank you, Mr. Chairman.

Chairman CONRAD. Thank you.

Senator Johnson.

Senator JOHNSON. Thank you, Mr. Chairman.

My background is in accounting. For the last 31 years, I have been operating a manufacturing business, so that background just naturally makes me search for root causes when you have got a problem. So to me, the root cause, really, of what ails us is the size, the scope, I mean, all the regulations, all the intrusion of government into our lives, and the cost of government.

I guess I want to first start out by just asking, right now, our Federal Government is almost 25 percent of our GDP. You add on State and local governments onto that and we are about 40, 41 percent. I mean, European-style socialists, not the countries, Norway is 40 percent, Greece is 47 percent, France is 53 percent. European countries are kind of stuck with about ten percent structural unemployment, much lower growth rates than we experience. I just kind of want everybody to comment on that basic premise. Dr. Zandi.

Dr. ZANDI. Yes. I think the size of government is inordinately high at this point. In part, it is because of the very severe recession that we have gone through and the weak recovery. But I think if you look at Federal Government expenditures as a share of GDP, it is 25.5 percent. The long-run average, meaning back to just after World War II, is 19.5 percent. You should be up or down relative to that given your demographic structure and lots of other factors, but that kind of gives you a sense of the magnitude of the problem, I would concur.

Dr. STONE. Well, one reason that the spending-to-GDP is high is because GDP is low, but nevertheless, spending is high. But it is high historically. But I would urge members to look at the testimony of CBO Director Elmendorf this week before the Special Committee about the fact that the choices that you will face of dealing with the deficits down the road are much more complicated now because of changes in the economy and changes in the demographics, that looking at historical spending ratios is not something that we can easily go back to without really cutting to the bone of programs that enjoy a lot of support and do a lot of good.

Dr. HASSETT. There is a big literature on long-term growth, the determinants of it, that Robert Barro at Harvard is one of the leaders of, and one of the more reliable results in that literature is that

if your government-to-GDP is high, then you do not grow very much. And we understand the channels through which that effect occurs. One is that a lot of growth often comes from innovation and inventing cool things and government does not do that, right. And the second thing is that when you have a big government sector, then they bid up the wages for everybody else and make businesses not competitive. Those are the channels.

Senator JOHNSON. Yes. I was interested in your analysis of the three states of Keynesian stimulus, and from my standpoint, are we not just stuck in stage one? When you take a look at the ten-year projections, we never—we never balance the budget. I mean, all we are really talking about is the size of the stimulus on a year-by-year basis. I mean, how do we ever get out of this? We certainly do not get out of it by increasing that stimulus this year by $450 billion, is that not true?

Dr. HASSETT. That is right. We are kind of stuck in a dependency cycle. After I wrote about this in the Wall Street Journal a couple of months ago, someone sent me an email and they mentioned that Keynes himself even wrote about this, that you have to avoid being in a period where you just keep doing a stimulus every year. And we are stuck in that and we need to get out with a big permanent fix.

Senator JOHNSON. Dr. Zandi, you talked about long term, where about 20 percent of the size of government really should be GDP, but also long-term, regardless of the top marginal tax rate, our revenue generation is about 18 percent. I mean, how do we ever address that structural deficit without recognizing the fact that, by and large, all we are going to be able to extract out of our economy in terms of Federal taxation is about 18 percent?

Dr. ZANDI. I agree with your view. I think that we need to close that structural deficit. This is what I worry about. I think the economy is very close to going into recession. If we go into recession, our fiscal problems are going to get magnified many times over, and these numbers you are talking about are going to get a lot worse very fast. So we need to be—and you may not believe me. You may not buy into my view, but we are——

Senator JOHNSON. Let me just——

Dr. ZANDI. But I think we should work really hard at avoiding it. So the debate—I do not disagree with you. I think the discussion is what are we going to do to make sure we do not go into recession now, because if we do, we have got a boatload of problems.

Senator JOHNSON. Here is my problem with your prescription: It is based on timing. And let us face it. Throughout economic history, I do not believe government has proven to be particularly effective at managing economies or being able to precisely time them. I realize you are economists. I am not. I am an accountant. I take a look at the——

Dr. ZANDI. That is pretty close.

Senator JOHNSON. I take a look at government estimates. For example, in the fiscal year 2009 budget, we estimated revenue for 2010, 2011, and 2012 at $9.3 trillion. Right now, we are looking at it being about $7 trillion. We were off by more than 30 percent. So I just do not see how we can fine-tune time, you know, a $450 billion deficit, or stimulus. I think what we need to do is go back to

the root cause and start realizing that regulations are a huge problem. The size of government is simply too big and we need to start dialing that back. I mean, does that not make sense as opposed to trying to think that we are so smart that we can fine-tune these fiscal prescriptions?

Dr. ZANDI. I am more—I would like to respond. Chad, sorry.

Dr. STONE. No, that is fine.

Dr. ZANDI. I have more faith than you. I think we need for you to do this. You have to get the timing right. And I do not agree that everything that policy makers have done has been a mistake. Yes, there are a lot of things that have been done. Some of the things, I would not have done if I were king for the day. But you take the totality of what the Bush administration did, the Obama administration has done, what the Federal Reserve has done, what the FDIC has done, it is really quite impressive. We cannot——

Senator JOHNSON. All the government action——

Dr. ZANDI. We cannot give up.

Senator JOHNSON. All the government actions that caused that housing bubble, I mean, all we are doing is we are reacting to the harm government caused. So that would be my point. Let us take a look at government and first require of government, do no harm. So you take a look at things that currently the government is harming our economy—regulations, taxes. I mean, does anybody really dispute that taxing the economy does not do harm? Now, I realize we do have to have a certain level of taxation, but it creates harm. Why would we want to increase taxes, particularly in a time of economic weakness? I just do not get that at all.

Dr. ZANDI. I do not, either. No one is advocating that. What I am saying——

Senator JOHNSON. We are asking for a balanced approach in terms of a long-term, credible spending restraint plan, and what I am saying is how about have our policy prescriptions centered around economic growth so that we can get the size of government down to 18 percent by growing our economy. Let us work on the denominator rather than the numerator.

Dr. STONE. First, I was going to say something similar to what Dr. Zandi said about the fact that we are not talking about fine-tuning the economy right now. We are talking about dealing with a major sluggish economic recovery and lots of hardship and waste, and we can really benefit from proposals like what the President had to prevent the further drag that the withdrawal of existing actions would have——

Senator JOHNSON. A four——

Dr. STONE. We will disagree on that.

Senator JOHNSON. A $450 billion stimulus in a $14.5 trillion economy is fine tuning, and again, it has not worked in the past. It obviously has not worked. Why would it work in the future, other than to increase the debt, which is our problem. Our debt-to-GDP ratio is simply unsustainable. So that is—again, I just have my concerns.

Thank you, Mr. Chairman.

Chairman CONRAD. Thanks, Senator.

Senator Whitehouse.

Senator WHITEHOUSE. There are not many of them left because time has gone by, but I think there are a considerable number of people who would agree that government action in the Great Depression through the Works Progress Administration and other things was essential to America's survival. And while the current recession that we are in is significantly less than the Great Depression, so are the policy prescriptions that we are talking about. We are really nibbling around the edges compared to the kind of interventions that Franklin Roosevelt led that got us through the Great Depression. So I just wanted to make sure that that piece of our history was recognized in this discussion.

What I hear more than anything else from people who are watching this debate in Rhode Island, in my home State, are two things. One is, I am willing to help. I am willing to help. But if I am going to help, I want the feeling that we are in this together. I do not really trust you guys in Washington to put everybody in together. I worry that there are a favored few who have strings that they can pull in Washington who are not going to be asked to contribute and that offends the Rhode Island sense of fairness and that causes a lot of suspicion to kind of cloud around what we are doing.

The other thing that I hear is, for God's sake, get this done for once and for all. Let us make the big decisions. Let us move on to other things. I am tired of this being a constant nickel and dime and we cannot move on to other issues.

So in the context of the first one, we want everybody to pitch in on this, I am very concerned that you have the most famous rich person in America, Warren Buffett, saying, hey, we rich people are being coddled by the existing tax system. Now, that was his word. You look at the IRS information and it tends to confirm that. The 400 richest—I am sorry—the 400 highest-income Americans, rounding at about a quarter-of-a-billion dollars each in income in the last year that the IRS measured, paid, on average, 18.2 percent in Federal taxes, which equates to what in the Providence labor market the Bureau of Labor Statistics says a truck driver makes. Probably everybody in this room pays a higher rate than 18.2 percent. The previous year, it was 16.7 percent.

If you look at pockets of wealth, like the Helmsley Building, which is its own zip code and therefore you can drag out IRS information from it by zip code, ditto. Very, very low. It turns out that the janitors and the doormen and the cleaning people in the Helmsley Building probably pay higher taxes than the occupants of the Helmsley Building.

So we, in many respects, have an upside-down economy.

My colleagues often point out that the top one percent of Americans pay, whatever it is, 30 percent of the income taxes, but that tends to focus, A, only on income taxes, and it tends to overlook the fact that they also take 25 percent of the income every year and own more than 30 percent of the wealth. So if you are just going on a flat tax rate based on wealth or income, we are about there right now and it is a lot of the kind of moderately-wealthy people who are rolling up those taxes and at the high end the numbers drop to 18—like I said, on average, 18.2 percent.

I know this is a little bit beyond the field of economics, but our capacity to address this problem is, to a degree, limited by public

tolerance for what we can do. And it just strikes me that if we are going to generate public tolerance to make the big step that Rhode Islanders are looking for, to get this solved, that it really is important that we take Warren Buffett's advice and that there not be a situation in which people making a quarter-of-a-billion dollars a year are paying a tax rate that is lower than or equal to what a truck driver pays, all taxes in.

So I would like your observation on that. Is there any economic issue there or is that just kind of a cultural and political issue that we need to address? Dr. Zandi, and then Dr. Stone, and then Dr. Hassett.

Dr. ZANDI. I am sympathetic with your characterization of the skewing of the distribution of income and wealth.

That is how I would characterize what you said. You know, if you look at the data, it is pretty clear that the share of income, the share of wealth accruing to the upper groups has risen pretty consistently over the past—since the early 1980s.

Senator WHITEHOUSE. And in the last decade-plus, their taxes have dropped considerably, enormously, in ways that no other segment of society can match.

Dr. ZANDI. And you are also right. Economists always have a hard time talking about these issues because we do not focus on questions, generally, of fairness, but questions of how the economy is functioning. But I think you can make a case, or at least it is something we should be worried about, that the skewing of the distribution of income and wealth could, in fact, because of political reasons and other reasons, affect decisions, policy decisions, and thus the well-functioning of the economy. I sympathize with this.

I think the—and, in fact, when we think about the $4 trillion deficit reduction, I think it is appropriate to consider it through the prism of what it means for the distribution of income and wealth. I think that is an appropriate criteria to consider in that process.

I will say, though, that I do think that, with respect to tax reform, that if you solely focus on let us reduce the deductions and credits in the code, the loopholes, that you accomplish so many things. You make the system fairer. Everyone can buy into that. It is less complex. Therefore, they understand it and, therefore, they do not think they are getting ripped off. And it will ding the higher-income households because they are the folks—me—who are deducting mortgage interest and taking all these deductions and credits in the code. So I think that is a reasonable approach that——

Senator WHITEHOUSE. Well, let me jump in there on the corporate tax code. My time is expiring, so let me jump to this, and I will go over so I am not just hearing from one person. I am going to ask Dr. Stone next.

CVS, a great Rhode Island corporation, headquarters in Woonsocket, Rhode Island, you know, stores across the country, provides a great service to Americans with low cost, high-quality retail pharmaceuticals and drug store type stuff, pays a solid 35 percent tax rate on its profits. Carnival Cruise Line—I have got nothing against Carnival Cruise Line. Rhode Islanders go on cruises. That is all fine. But I think their last tax rate was 0.8 percent or something, compared to 35 percent. They paid about one fif-

tieth the tax rate of CVS. General Electric had a negative tax rate. They actually got money from the taxpayers on the billions of dollars that they earned.

Dr. Stone, does it make any sense to have that kind of discrepancy in the corporate tax code, and should we, if we are moving towards a flat rate, be considering areas—and I would contend that potentially green energy is one—where there is an international competition to seize a controlling share, if you will, of an emerging market and that we need to be internationally competitive, and therefore, in that one context, it might make sense to provide some tax support? Is that a fair way to look at this question, or how would you look at it?

Dr. STONE. Well, you are right about the disparities across corporations because of the way the corporate tax code is currently structured. We have high marginal tax rates and everyone focuses on those, the 35 percent that CVS pays, but we have lots and lots of ways that you reduce your average taxes, and that is why we have a quite low average corporate tax rate, and the idea of corporate tax reform is to broaden the base, maybe bring the rates down, and from my standpoint, bring in some revenue.

The reason we have corporate tax expenditures is we want to encourage worthwhile activities, but we do not want it to show up as government spending because somehow that is bad and the tax code is good. It is the same thing.

So encouraging green technologies, good idea. Maybe the tax code is the best way to do it. Maybe there are other ways.

Senator WHITEHOUSE. Thank you, Chairman.

Chairman CONRAD. Thank you.

Senator Wyden.

Senator WYDEN. Thank you, Mr. Chairman. This has been an excellent panel.

I want to talk about tax reform in a little bit of a different way and I am going to do it largely because I think this is a big moment for tax reform and something that I am just thrilled to see us arrive at. I put in my first tax reform bill with Rahm Emanuel, to give you an idea some of the history, and then Senator Gregg and I spent two years, week after week after week, producing the first bipartisan tax reform bill. And then we have had the good fortune of having Senator Coats and Senator Begich be part of it. So it is a bipartisan kind of effort, and listening to all of you, you can see some of the possibilities in terms of the benefits to the country.

You look, for example, at the Bureau of Labor Statistics figures. In the two years after the 1986 tax reform bill, the country created 6.3 million new jobs. That speaks right exactly to the point you have been talking about, Mr. Stone, and I think very eloquently.

It addresses the predictability question that I think both Mr. Hassett and Mr. Zandi have been talking about, because we all understand that business is saying, my goodness, we cannot possibly predict what is going to happen, and I think it is clear that there is an opportunity to show our people that there will be a certain sense of fairness from the changes and the simplicity.

The big question, what I want to get into with you, is we are really fighting the clock. We are fighting the clock because we have got this super committee. It is a question of how much tax reform

they can do in the committee and then the rest of it, for example, could be done by the Ways and Means Committee and the Finance Committee, perhaps under a short kind of time line. And that is why I continue to be so committed to the 1986 model, is it is understandable. Basically, apropos of this question we have been talking about, you are trading preferences for cash to lower marginal rates while keeping progressivity, essentially the model of 1986.

So let me begin my questioning with you, Mr. Hassett, and you, Mr. Zandi. Would it be fair to say, given the time crunch and the press of so many issues on the super committee, that it would still make sense to use that 1986 model? By the way, I think they are going to have trouble getting anything else scored. Chairman Conrad is here and I think he will be interested in this. It is going to be very hard to get any other tax reform model actually scored. The Joint Committee on Taxation spent months after months after months working with us and now we have a scored bill. They have not even been able to score the Bowles-Simpson model.

So I would like to kind of start with Mr. Hassett and Mr. Zandi, that on the tax reform issue, would it not make sense—we have done it before, Democrats, Ronald Reagan—to take the 1986 model as the template and then have the debate about the rates and the additions and the like so at least we can get started on this? Mr. Hassett.

Dr. HASSETT. That is a great idea, Senator Wyden. In fact, I think that I can say that one of the favorite proposals of Republicans at dinner parties for the last decade has been the "back to the future" plan that starts with the 1986 tax code and then starts adding things that we think that we added since then that are good. It turns out that that list is pretty small.

Senator Wyden. Okay. Mr. Zandi.

Dr. Zandi. Yes, I would concur. I think you are right about the history. I mean, the tax reform, the 1986 tax reform was a very significant achievement and did lay the foundation for much better growth long run. I think that would be an interesting—I had not thought about that until you mentioned it, but I think that would be a good prototype for the current debate.

Senator Wyden. Well, I appreciate that, because then you can have a discussion about looking at the various options and almost dial the rates in line with the information we have from the Joint Committee on Taxation. For example, the Bowles-Simpson rates are different than what I have had with Senator Gregg and Senator Coats and Senator Begich. They go to 12–22–29, largely on the personal rates. But we can provide, for example, for the debate, the information so that if you adjust, for example, the top rate by one percentage point, you will know what it costs. Would that not make sense in terms of trying to structure the debate? Do any of you want to comment on that?

Dr. HASSETT. Yes, it makes sense.

Senator WYDEN. Okay. Mr. Hassett, I want to ask you a question in terms of the business rates, because this is an area where we spent an enormous amount of time and sort of took as our kind of lodestar that we wanted to have competitive rates for American business, competitive rates solve a lot of problems. I mean, our corporate rate is 24, for example. That is really the lowest on offer.

You could adjust it one way or the other, but it would be a competitive rate.

And my understanding from what you have said, you have been concerned about this issue particularly as it relates to domestic businesses, small businesses, and larger businesses because you are concerned they are not getting fair treatment relative to the multinationals. Now, I want all three of them to get fair treatment, small businesses in the United States, larger business in the United States, and I want our multinationals to be competitive. But tell us your thoughts with respect to this issue and, again, any sense you have about eliminating preferences to drive down the rates.

Dr. HASSETT. Thank you for the question, Senator. I think that it is really important to emphasize a very underappreciated fact about the corporate tax that I mentioned in my testimony, but that right now, the average tax on foreign income for U.S. multinationals is probably something like 17 percent, and so what that means is that if you have a company like CVS that does not have access to the option to shift its intellectual property offshore and then pay royalties to foreign subsidiaries and so on, then they pay a much higher tax.

If you were to just cut the U.S. corporate rate, say, all the way to 17 percent, then the typical multinational with activity abroad might even be indifferent, right, because they are saying, well, that is about what I am paying on tax right now anyway, but the U.S. worker would not, and that is the important point, because then, all of a sudden, all these people who have a really strong incentive to do the stuff offshore and create the jobs over there would be creating the jobs at home.

And so I think that within the corporate community, there are going to be winners and losers as you construct a tax reform. But the point is that the workers of America, the people of America, they are going to be winners because we are going to be encouraging people to have their activity at home now.

Senator WYDEN. What encourages me—I see the Chairman has got his gavel in his hand—is you are a conservative, I think you would say that by any kind of political perspective, and you are advocating for red, white, and blue jobs and doing it in a way that ensures that each of those businesses, the small business, the domestic business, the multinational, be competitive, and much again of the more complicated approaches are going to be hard to do.

Senator Gregg and I—and I will wrap up with this, Mr. Chairman—Senator Gregg and I probably spent a gazillion, quadrillion hours—barely an exaggeration—looking at this territorial issue, and I continue to be open to it. But as you know, Mr. Hassett, it involves a whole host of issues, transfer pricing, where you generate a sale over here, you book the profit over there. You get the competitive rates which you are talking about and you solve a lot of problems. Sheldon Whitehouse could tell CVS they are going to be part of a tax system where they get a competitive rate. The small businesses and NFIB benefits, as well. You do not go through some of the extraordinary complications of getting too territorial.

Mr. Chairman, another good hearing. I look forward to working with you.

Chairman CONRAD. Senator Wyden, thank you, and thank you for the efforts that you and Senator Gregg made on fundamental tax reform. Really, what the two of you did was the blueprint for what was done in the Fiscal Commission and the Group of Six. And I tell you, I personally believe that it would pay huge dividends for this country.

We have a tax code that no one would write if you started from scratch today. It is a monstrosity. I used to be a tax administrator. I was the Tax Commissioner of my State. I was Chairman of the Multi-State Tax Commission. In the Reagan administration, I served on a commission on the taxation of multinational corporations. I spent a lot of time negotiating with Europeans and the Asians on tax policy internationally.

Our tax policy is absolutely a disaster, and it is a special disaster now that we have to worry about our competitive position in the world. This tax code was written at a time we did not have to worry about our competitive position. We were completely dominant. We no longer are. If you were concerned about our competitive position, you would never write a tax code like this one.

We ought to—I believe we ought to write a tax code that encourages savings and investment. You have got to have savings if you are going to have a pool of money for investment. You have got to have investment if you are going to grow. Our system does not encourage savings and investment, just the opposite. And you ought to enhance the competitive position of companies that are based here in this global competitive environment. It is a sort of a no brainer.

And this is an opportunity. Senator Sessions said it. We ought to seize this opportunity, and we ought not to delay tax reform. There is absolutely no reason for delay, and you have provided—you and Senator Gregg—really an outstanding blueprint for it.

I would like to take just a minute to talk about how we got in this mess from my perspective. Again, this is what I believe. Looking back since 9/11 we have had a collection of policies that created a stew, that created bubbles in housing and emergency and commodities, and that stew was a loose fiscal policy managed by the Fed—loose monetary policy managed by the Fed, loose fiscal policy managed by Congress and the administration, previous administration primarily, in my view, responsible, because we had lots of money growth, very low interest rates over a protracted period, at the very time we had a loose fiscal policy, massive increases in deficits and debt under the Bush administration, and with an overlay of deregulation.

I hear some of my colleagues say let us have more tax cuts and more deregulation. Really? That worked great. That is exactly what was done during the Bush administration, and at the end of the Bush administration, we were on the brink of financial collapse. If that was such a brilliant strategy, how is it that we were then on the brink of financial collapse? Because that is where we were.

Now, I personally believe it is an overly loose monetary policy, overly loose fiscal policy, and deregulation—or really not deregulation. There was no regulation of derivatives—that brought us to the brink of collapse. That does not mean we should not reduce regulations in other places because, clearly, we do have a regu-

latory burden. In many places it makes no sense. I do not argue against that.

But the notion that all regulation is bad is part of the reason we are in this mess. Hello. What was happening with AIG? A little small unit takes unbelievable risks with derivatives and puts us on the brink of financial failure. I will never forget being called to a meeting in the Capitol, the leadership of the House and the Senate, Republican and Democrat, and the Secretary of the Treasury in the Bush administration and the Chairman of the Federal Reserve saying to us they are taking over AIG the next morning because if they did not, there would be a financial collapse in 10 days. That was not the Secretary of the Treasury in this administration. That was the Secretary of the Treasury in the Bush administration, saying if they did not take over AIG, where there was no regulation of derivatives, that we would have a financial collapse.

So that is my own view of how we got in it, and how we get out is, I believe, a combination of things. I do believe when the economy is extraordinarily weak, the only one strong enough to come in and provide additional aggregate demand is the Federal Government. That is a Keynesian idea. I subscribe to it. I believe it is correct, that you have got to have the Government come in to provide a lift to aggregate demand; otherwise, the spiral will only get worse. I believe the policies adopted by, interestingly enough, the end of the Bush administration, by the Bush administration, and then followed by the Obama administration prevented a depression. I believe that. I believe history will record that. Dr. Zandi, your report suggests that.

I also believe that we are on an utterly unsustainable course with debt, and it is imperative that we put together a credible, serious, long-term debt reduction plan. So I have found myself at odds with the right and the left. I think both of them are not reacting to the reality of the moment that we face now that requires changes in an awful lot of what we are doing. And I believe that means fundamental tax reform to, yes, in part raise additional revenue, but I also believe we have got to cut spending, and I also believe we have got to reform the entitlements.

You know, some of my friends on the left do not want to reform entitlements. I do not think they are right. I think what the trustees have told us is true. Those programs are headed for insolvency if we fail to act. And I believe our friends on the right that say you do not have another dime of revenue are dead wrong. I believe they are both wrong. We not only have the highest spending in 60 years as a share of GDP; we have the lowest revenue in 60 years as a share of GDP. Both are true. And it is no wonder we have got record deficits and record debt.

And I also happen to agree—one place Senator Sessions and I do agree, I believe the report of Rogoff and Reinhart. When you get a debt of more than 90 percent of GDP, gross debt, you have endangered and weakened your future economic prospects. And I do not know, Senator Sessions, if it is 1 percent that is in the Rogoff-Reinhart analysis or it is the half of 1 percent Dr. Hassett is talking about. I think in a way we are talking about two different things because they are talking about the average from the 200 years of economic history, the 44 countries they examined. You are

talking, I think, about our specific circumstances. But in either case, we are talking about a reduction in future economic growth, and it would be wildly irresponsible for us not to respond. I think the differences here lie more in timing than they do in a question of what has to be done.

With that, I will recognize Senator Sessions—well, Senator Merkley has returned, but I have taken some time here awaiting your return. I would give Senator Sessions a chance to respond now, or if we would want to wait until after Senator Merkley, I would give him first up then.

Senator SESSIONS. Maybe I could just briefly, you know, I do not oppose, as I said, any regulations, all regulations, just those that are ineffective.

As to the housing bubble and the collapse financially that we suffered, I remember distinctly supporting my colleague Senator Shelby, who proposed, at the suggestion of President Bush and Alan Greenspan, significant controls on Freddie and Fannie, which were the core of the problem of the housing bubble. It passed the Committee on a purely partisan vote when he was Chairman, and a threatened filibuster killed it in the Senate. I think that would have made a difference.

I do not think it is fair to say this side just opposes all regulations and would respond on that. I would also note that the hearing, I think, Mr. Chairman, has highlighted the question, and you stated it again, and that is, Can we add another $450 billion to the debt? And will that short-term high—Bill Gross referred to it as a sugar high—that high that will be paid for in the future with the hangover, is that the right way to get us out of this situation? I just am losing confidence that it is. I think Mr. Hassett is saying that if this is going to be a slow, long progress out of a long financial debt crisis, the pay-for is going to come long before we are back in the kind of economy we want to see in America, and it will hammer us in. And then I guess we will be—they will tell us then, Mr. Hassett, Dr. Hassett, we need another one.

So that is the real question we are wrestling with. I think good people can disagree. Thank you for having this hearing and the good discussion we have had.

Chairman CONRAD. Yes, very good.

Senator Merkley.

Senator MERKLEY. Thank you, Mr. Chair, and thank you all for bringing your analysis to this hearing room.

I wanted to raise an issue that I do not think has been raised, which is essentially some of the practices in China, specifically the pegged currency which operates as a tariff on our products or a subsidy to Chinese products to us, both of which decrease the strength of manufacturing in our Nation, but also China's state banks subsidies, their financial repression or interest rate control that result in a negative interest rate that essentially transfers wealth in an informal tax from the citizens to the businesses, and the subsidies combined with loans and grants from the state banks that create very favorable circumstances for building a business in China. So these two things together comprise a substantial industrial policy.

How should we in America view this in terms of the impact on our economy? And what should we do in response?

Dr. Zandi, do you want to kick that off?

Dr. ZANDI. Sure. Thank you for the question.

I think it is fair to say that the Chinese currency is significantly undervalued vis-a-vis the U.S. dollar. I have done a bit of work in this area and I have seen other work. I think a rough estimate would be it is undervalued by 25, 30 percent, so it does put American manufacturers at a competitive disadvantage.

The Chinese are allowing their currency to appreciate 5, 6, 7 percent per annum. Sometimes they slow it down, sometimes they speed it up. But that is their plan, and they have articulated that, and they are going to do that ad infinitum into the future.

I think it would be desirable, preferable from our perspective and their perspective, frankly, that they would accelerate that process. It would be therapeutic for the global economy if they did. And I think that policymakers should work to that end.

I do not think, though, there are any legislative solutions to that problem. I think they would be counterproductive. I think that is something that should be left to discussions and negotiations with the Chinese to try to convince them of this.

And I will say one thing about the Chinese policy that is positive, and that is, we know exactly what they are going to do, which is clarity and you can plan for it. So businesses are plugging in 5, 6, 7 percent per annum ad infinitum into the future, which is not a bad thing. So there is some upside to that clarity. But I would not counsel any legislative action with respect to how to address that.

With respect to the other aspects of Chinese policy, you know, I think they are mostly on the margin. I do not know that they make a big difference. I will, though, say a strong Chinese economy now is vital to a strong global economy. If the Chinese economy were to weaken at this point, it would raise the odds that Europe would go into recession because Germany relies very heavily on selling to China. And it would jeopardize our own expansion.

So, you know, I understand what you are saying. I hear it. You know, some of the things they are doing I do not like, but I do not think that at this point it would be therapeutic to add them, at least not in a legislative way.

Senator MERKLEY. I do find it interesting that when we took a bipartisan delegation to China, we heard from American companies two things: one is that they were competing with folks who were getting huge subsidies from the state banks; and, second, that they felt they needed to be in China because of the markets; and, third, that they were given a huge amount of control on how they could operate, ranging from a tractor company being told that they needed to go big, go west, or get out. That means they could not build tractors to compete with Chinese tractors. They could not utilize the infrastructure in the east. They had to go west. And if they did not like it, too bad. And company after company talking about requirements for joint venture structures where technology was stripped, control was stripped, copyrights were stolen, et cetera. And it was amazing to see, because companies in the past had been very reluctant to talk about these negative aspects for fear of getting kicked out, but to see American companies one after the other

sharing their horror stories made a big impression, I think, on all of us who went there. And yet we are sitting here saying no controls on Chinese companies, operate anywhere you want, utilize the infrastructure anywhere you want. Certainly this 25-percent, 30-percent devaluation impact is an effective tariff.

We have quiet conversations. We have whispered in the ear for a long time. Is it time for us to have a more—I know you are saying no, but I think it is important for us to ask ourselves: Is it time to have a more aggressive conversation about a fair trading structure that does not take jobs out of America? That is what I am wrestling with. Do others want to comment?

Mr. SMITH. Well, I agree with Mark that it is—and I agree with your premise. It is a problem for American manufacturers. There is no question about it. It is a policy that the Chinese think works best for them. I think there are a lot of underlying problems. The state banks are going to be a problem for them. The fact that they are supporting their currency means they have to find ways to control inflationary pressures. There are a lot of pressures on them.

But they seem pretty committed to it, and I do not think we can do much legislatively to change that unless it is aimed as a negotiating strategy, and you generally do not want to use legislation, actual legislation, as a negotiating strategy.

Dr. HASSETT. The one thing I would like to add, Senator, too, is that China's advantages are dissipating and that a lot of activity—I know Mark has written about this—is moving to other corners of Asia, and that I think heightens the opportunity of the kind of reforms we have talked about today, because when we look up and we see, you know, chip manufacturers locating their foundries in Malaysia and, you know, the foundry has almost no labor, one guy pushes "Start" in the morning and all these robots make the chips. But they are taking these very capital intensive things and locating them in places that are not in the United States. Well, that is not because of China's currency, you know, and it is not because of relative labor costs. It is because of other fundamentals like the fact that we have such a terrible Tax Code and they get a big tax advantage for being offshore. And so I think that if we fix the United States, then the concerns that you raise, which are legitimate ones, will be a lot less relevant because people will really want to be home in the United States again.

Thank you.

Senator MERKLEY. I want to switch to a second question, and I guess there will be very little time for you to respond because it is almost time. But in housing, we have an enormous cloud of foreclosures hanging over our country, possibly another 5 to 8 million by various estimates. We have huge debt overhang for American families. A big piece of that is the debt on their properties, including their second mortgages, third mortgages. These two pieces, we have not seen movement of an economy out of the ditch without housing being part of the solution.

How do we make housing part of the solution?

Dr. ZANDI. I know you have done a lot of really good work in this area, and I support a lot of it. I think that there are two things that could be done that would make a difference in the very near future. First is I would not allow the conforming loan limits that

will expire in a couple weeks to expire. I would extend the higher conforming loan limits. It is on the margin. It really helps the Northeast and California, maybe some areas in the Pacific Northwest, but, nonetheless, everything is on the margin at this point.

The second and perhaps more efficacious effort would be to stimulate more mortgage refinancing activity. I would do a few things to juice up the HARP program. We have fixed mortgage rates at a record low, 4 percent. The average coupon on a Fannie-Freddie mortgage—the median coupon is 5.5 percent, so half of mortgages are above 5.5 percent. These are clearly mortgages that could be refinanced. You could lower these folks' monthly payment overnight, and it would help provide more cash to them. It would be stimulus to the economy, and it would help reduce the odds of default.

It is not a slam-dunk. You know, you have investors that do not get the interest income, but on net, I think that is a very positive way to do it. Of course, that has to be—it is not through legislation. You have to work through the FHFA because this is on Fannie and Freddie.

Senator MERKLEY. I am out of time or, otherwise, I would have you all chime in, but, Mr. Chair, thank you very much.

Chairman CONRAD. Thank you, Senator, and I thank the witnesses. We appreciate very much your participation in this hearing today.

I would say to Senator Sessions, do you have any last word that you would want to say?

Senator SESSIONS. Thank you, Mr. Chairman, for the hearing, and I do believe that we are wrestling with this question. Do we accept the President's proposal to increase spending, increase debt, and raise taxes as an effort to assuage the uneasy poor growth pattern that we are now seeing? I am afraid the danger is more real than the benefit.

Chairman CONRAD. All right. We appreciate that. Obviously, I have a somewhat different view. My own judgment is in the context of an overall plan to get deficit and debt down, I am concerned about the risk of going into recession and how that would actually add to our debt and deficit problem. So I think it is worth taking aggressive steps now to try to avert a recession.

But I also want to say for those who might be listening that Senator Sessions and I will be working on a plan for budget process reform. We have not reached a conclusion. We are going to be holding hearings on this subject. I do believe that this is a time that we could get something done that would be very important for this institution and important for the country to improve the budget process here. And I am going to be leaving. I really do not want to leave this budget process to whoever follows because this budget process is not working the way it should. The one thing we can agree on is that.

I also think we can agree on some of the fixes. Going to a 2-year budget process I think would be a significant improvement. And we have also got to talk about some other issues as well, but that will be the subject of another hearing.

Again, I just want to close by thanking so much the witnesses, Dr. Zandi, Dr. Stone, Dr. Hassett. You have all contributed to the work of this Committee, and we appreciate it.

[Whereupon, at 11:52 a.m., the Committee was adjourned.]

Questions for the Record
By Senator Sheldon Whitehouse
Policy Prescriptions for the Economy
September 15, 2011
Senate Budget Committee

For Dr. Zandi:
President Obama included in Section 351 of his American Jobs Act a tax credit for employers that hire the long-term unemployed. In June, I introduced a similar credit in my Job Creation Tax Credit Act of 2011 (S. 1271). I've heard from many business owners in Rhode Island who would like to expand but who fear the uncertain economy. How might a $4,000 tax credit help to change the calculus for an employer on the fence about hiring? Would business expansions facilitated by such a credit contribute to the economy beyond 2012? How many jobs would you estimate the Section 351 credit would create in 2012 and beyond?

Unlike the credit I proposed in S. 1271, the President's proposed credit would be "non-refundable" – in other words, companies not making profits and paying taxes could not benefit from it. Would you recommend that a hiring credit be refundable so that struggling companies could benefit? If the Section 351 credit were made refundable, how many additional jobs could be created? If S. 1271 were enacted instead, what would be your estimate for the number of jobs created?

Ron Wyden

Sen. Wyden's question for the record for Moody's Chief Economist Mark Zandi following his testimony before a Budget Committee hearing on Policy Prescriptions for the Economy, which the committee held September 15, 2011

Dr. Zandi, you've testified before Congress that increasing infrastructure spending will greatly boost the economy, particularly when an economic downturn lasts for an extended period like the current one and that most of the infrastructure money will be spent on hiring workers and on materials and equipment produced domestically.

You've also testified that tax cuts generally provide less of an economic boost, particularly if they are temporary; on the other hand they can be implemented quickly.

I'd like to ask you about an approach that combines both -- tax credit bonds targeted at transportation infrastructure. Transportation Secretary LaHood testified before this committee that projects funded by infrastructure bonds create the same number of jobs as direct transportation spending.

And as we've seen with the Build America Bonds program, where $181 billion in bonds were issued in about 18 months, bonds can be a way to get project funding out the door quickly.

- Wouldn't you agree that a bond program like Build America Bonds targeted at transportation projects could be a way to get a substantial economic boost that will lay the foundation for future economic growth and do that relatively quickly?

In response to Senator Whitehouse's questions:

Temporary tax breaks for businesses that expand their payrolls by hiring the long-term unemployed is a good approach to jump-start hiring of those in most need of help. President's proposal in section 351 of the American Jobs Act and your proposal in S. 1271 are good examples of such tax credits.

The principal economic logic behind such a tax break is that temporarily reducing the cost of labor will prod businesses to hire. Targeting workers who have been unemployed for an extended period also addresses the mounting problem of structural unemployment. The longer workers stay out of work the more difficult it is for them to get another job as their skills and marketability erode. Structural unemployment is increasing quickly, from an estimated no more than 5% prior to the Great Recession to near 5.5% currently. It is sure to rise even more given the currently weak job market.

Key to a job tax credit working well is that businesses must be confident that there is sufficient demand for whatever their new employees will produce. Policy efforts to shore up demand such as extending and expanding the current payroll tax holiday for employees as proposed by the President are thus very important. Many businesses also need access to credit to finance expansion and increase hiring, and policy steps to facilitate the flow of credit, particularly to smaller businesses, are thus also important. Only when demand is sufficiently strong and credit is ample will businesses focus on the cost of labor and whether it makes sense to add jobs.

There are some downsides to providing tax breaks for hiring. The most obvious is their cost. The ultimate costs—after accounting for the additional tax revenues and lower government spending from a better job market and stronger economy—are lower. Still, unless these costs are covered, they will add to the nation's already-daunting long-term fiscal problems. Job tax breaks are also not particularly efficient, in that most firms that receive the benefit would arguably have increased their payrolls without it. It probably is not a bad thing to provide a boost to these businesses, as they likely are the engines of job growth, but the number of jobs directly created because of firms' temporarily lower taxes is modest.

Yet weighing all the potential pluses and minuses, a job tax break still seems a worthwhile policy effort at this point in the economic recovery. A well-designed and appropriately sized tax break will measurably raise the odds that hiring will revive in earnest and that the recovery will evolve into a self-sustaining economic expansion.

Gauging the employment impact of such tax breaks is very difficult given the lack of historical experience. There was a similar job tax credit in the late 1970s, but it was not well publicized and many businesses were unaware of it. The employment impact of the HIRE act is still not known as the business tax returns needed for such an analysis are still unavailable. My early 2010 estimate that the HIRE act would result in a peak impact of an additional 250,000 jobs still holds (see "Jump-Starting the Job Market: How Well Will a Job Tax Credit Work," Zandi, *Moody's Analytics Special Study*, February 8, 2010).

The President's proposal in section 351 of the American Jobs Act would result in fewer additional jobs than the HIRE Act, in large part because it is applies to workers who have been unemployed for more than 6 months compared to 2 months in the HIRE Act. Section 351 also provides a smaller tax credit than in the HIRE Act.

The section 351 tax credit is non-refundable and thus companies that are not profitable and not paying taxes are not eligible for the credit. Making the credit nonrefundable would be helpful to struggling businesses, but is unlikely to generate many additional jobs. Struggling companies are not very likely to add additional jobs and the credit is not large enough to make a big enough difference in their financial health.

Unfortunately, I have not yet done a thorough analysis of your proposal S. 1271 to determine how many additional jobs it would create. I would be happy to do this, but will need to gain a better understanding of your proposal.

In response to Senator Wyden's question:

I agree that a bond program like that of Build America Bonds targeted at transportation projects would be an efficacious way to finance these projects. Moreover, these types of projects provide a substantial economic boost and the bang-for-the-buck – the GDP impact per dollar of tax subsidy – is high, particularly now, when there are so many unemployed construction workers. Such infrastructure spending can also help remote and hard-pressed regional economies and produces long-lasting economic benefits.

As you point out, BABs were very popular and successful in providing financing for infrastructure development. By subsidizing the interest payments of qualified municipal issues, the program made municipal bonds attractive to a much larger taxable investor base. As such, state and local governments were able to obtain much cheaper financing than in the regular municipal bond market. BABs were also issued quickly, thus allowing projects to get underway quickly.

It is important to note, however, that the economic benefits of such projects generally take at least a year to materialize. This isn't a significant drawback given that unemployment is likely to remain high for the next several years, but infrastructure spending should not be counted on to provide many jobs in the next year.

A bond program should also not be considered in lieu of other proposals to facilitate the financing of transportation and other infrastructure projects. The President's proposal in the American Jobs Act for an infrastructure bank—a government entity with a federal endowment, able to provide loans and guarantees to jump-start private projects. also has significant merit – also has significant merit. Private investors and developers would determine which projects to pursue based on what works financially rather than politically.

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Jump-Starting the Job Market: How Well Will a Job Tax Credit Work

Mark Zandi
February 08, 2010

121 N. Walnut Street • Suite 500 • West Chester, PA 19380 • USA
help@economy.com • 866.275.3266 (inside the USA) • 610.235.5000 (outside the USA)

Jump-Starting the Job Market: How Well Will a Job Tax Credit Work

Mark Zandi
February 08, 2010

The Great Recession is over, and an economic recovery has begun. Real GDP grew at a strong 4% average annualized rate during the second half of 2009, powered by a massive inventory swing and an unprecedented monetary and fiscal stimulus. These are temporary boosts, however, and until businesses respond by hiring more workers, it is unclear that the recovery will evolve into a self-sustaining economic expansion. The situation is particularly worrisome given that employment continues to decline and the unemployment rate is already close to double digits.

Policymakers are rightly focused on addressing the troubled job market. The Obama administration and the House of Representatives have proposed legislation that provides temporary tax cuts and spending increases in hopes of restarting the job market. The Senate will follow soon. Proposals being discussed include increased credit to small businesses, additional infrastructure spending and more public-service and summer youth jobs.

Also being debated are temporary tax breaks for businesses that expand their payrolls. Proponents hope a well-timed and meaningful reduction in the cost of labor will be the catalyst businesses need to resume hiring.

Gauging the employment impact of such tax breaks is very difficult. There was only one similar job tax credit in the late 1970s, but it was not well publicized and many businesses did not know about it. Much also depends on how the tax break is structured. Concerns about businesses cheating or gaming the tax benefit are reasonable, and safeguards to minimize abuse could make the process more complicated and less attractive, reducing participation.

Despite this uncertainty, however, a tax break is the best idea currently under consideration for ensuring the U.S. job machine kicks into full gear later this year. The plan could be particularly effective if implemented by late spring. Firms by then will have had time to regain their confidence, and banks should be extending credit somewhat more freely.

This article reviews conditions in the troubled job market and considers reasons for its ongoing difficulty. The advantages and disadvantages of a jobs tax break are considered broadly, and then more specifically in regard to proposals by the Obama administration, Senators Casey and Gillibrand, and Senators Schumer and Hatch.

Using the Moody's Economy.com macroeconometric model, we can quantify the plans' effects on employment and the broader economy. The models' simulations suggest the president's proposal would have the greatest impact, resulting in a maximum addition of 725,000 payroll jobs. The Casey-Gillibrand proposal would add 670,000 additional jobs and the Schumer-Hatch proposal would add some 250,000 jobs. The different employment impacts largely reflect differences in the size of the proposals. The president's plan adds nearly three times as many jobs as the Schumer plan, but it also costs approximately three times as much. In other words, the budgetary bang-for-the-buck of the plans is similar.

How bad is it?

The severity and breadth of the job market's problems are clear. The unemployment rate has surged to near 10%, despite a very unusual decline in the labor force.[1] Unemployed workers are likely leaving the job market, perceiving that there are no jobs to be had. Indeed, there are now almost six unemployed workers for each available position. In normal economic times, there is at most one unemployed worker per open position. If the labor force were growing at closer to the 1% annual pace that prevailed just before the recession, the unemployment rate would be well over 11%.[2]

Anyone who loses a job has an extraordinarily difficult time finding another. The average length of unemployment has risen above six months, and well over a third of the unemployed have been out of work for more than the 26 weeks normally covered by unemployment insurance. Even in the early 1980s' downturn—the last time the unemployment rate was in double digits—only a fourth of the unemployed were out of work that long. During the worst recession of the 1930s, closer to one-tenth of workers were in this difficult position.

The unemployment statistics are bad, but they still understate the stress in the job market. Including those working part-time because they cannot find full-time work and those who want to work but not counted as unemployed because they have not looked for jobs in the past month, the so-called underemployment rate jumps to almost 17%. This is the highest level since the Great Depression (see Chart 1)[3] and represents 25 million Americans.

Some recent signs have been encouraging. The rate of job loss is down significantly, from nearly 700,000 per month in the first quarter of 2009 to fewer than 100,000 in the fourth quarter. Initial claims for unemployment insurance have fallen from a peak above 650,000 per week to around 450,000. A rate of new unemployment claims closer to 400,000 per week would be consistent with stable payrolls. The number of temporary jobs has also risen recently, a positive leading indicator, as businesses hire more temps before they add full-time workers. The Census Bureau will also soon begin to hire more than a million temporary workers to conduct the 2010 Census. All this is good news, suggesting job growth is set to resume soon. But it is not nearly good enough.

[1] The last time the labor force declined as significantly was during the Korean War in the early 1950s. The statistics cited in this section are from the BLS.
[2] The highest unemployment rate since the Great Depression was the 10.8% suffered in late 1982.
[3] This is the so-called U6 unemployment rate, which the BLS constructs going back to 1994. Prior to 1994, the data are estimated by Moody's Economy.com.

Chart 1: Lost in Unemployment
% of labor force that is unemployed and underemployed

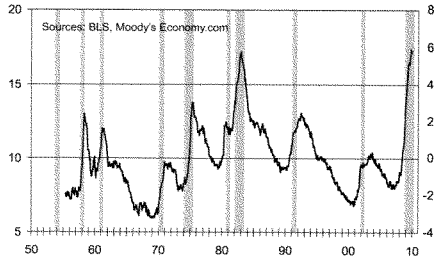
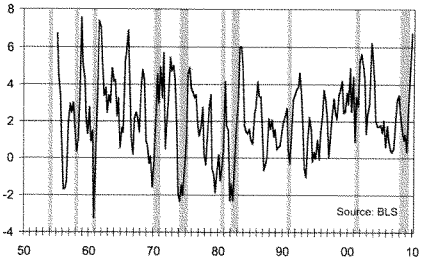


Chart 2: Productivity Soars
Annualized % change, 3 qtrs



What's the threat?

Historically, changes in employment and unemployment closely follow changes in GDP. Output rises coming out of recessions; employment increases a few months later, and unemployment begins to decline some months after that,. In the past, businesses could not produce more without hiring more workers. Unemployment took a bit longer to fall as formerly discouraged workers rejoined the job market. In the time it took for this group to find work, the unemployment rate would increase before beginning to decline.

This dynamic of stronger output leading to hiring leading to lower unemployment has been important in the transition from recession to recovery to expansion. Without the additional jobs and income, consumers do not have the confidence to spend more aggressively, which is precisely what is required for businesses to increase output.

In more recent business cycles, including the 1990-1991 and 2001 downturns, this dynamic has held less strongly. GDP increased as the recessions ended, but hiring lagged, and unemployment lagged even more. Expansions ultimately took hold, but the jobless recoveries of these periods made the transition difficult. This dynamic seems to have broken down even further in the current cycle. GDP swung from a sharp decline to an increase in the third quarter of 2009, and while job losses have become less severe, they continue.

The current recovery has continued despite the lagging job market only because of the support to household incomes coming from the federal government. Automatic stabilizers and the fiscal stimulus have sharply lowered tax burdens and increased transfer payments.[4] After-tax incomes have risen a bit over the past year, but only because help from the federal government has more than offset moribund wage growth.

Concern about the job market would be less acute if unemployment were not already so high. With such a surfeit of labor, already-weak compensation growth threatens to stall or even decline. It is not unusual for real, or inflation-adjusted, compensation growth to fall in recessions, but nominal compensation has not fallen since the Great Depression. Falling compensation would be the catalyst for a pernicious deflationary cycle.

What's ailing the job market?

The most straightforward answer to why employment continues to decline despite rising GDP is that productivity has increased—indeed, it has soared. Productivity expanded at close to a 7% annualized pace during the last three quarters of 2009, among the strongest gains seen since World War II (see Chart 2). Productivity growth weakened during the Great Recession, but it never fell.[5]

Businesses will not be able to raise productivity indefinitely, but neither are they likely to give up gains they have achieved, particularly if the surge is due to information technology investments made since the mid-1990s. Information technology has powered productivity growth for years, but businesses may not have been able to take full advantage of it because of the costs associated with significantly cutting payrolls. There is less financial pressure to make such changes when times are good. But in tough times such as now, firms are more willing and able to change. The result is a measurable and permanent downward shift in the number of workers needed to produce a given level of GDP.

This does not need to be bad for workers, assuming businesses use the profits generated by productivity gains to expand and eventually add to payrolls. Such a process is particularly important now, with demand already fragile. But it has yet to happen. Businesses are scaling back layoffs—although they remain uncomfortably high—but hiring remains dormant. The number of workers hired each month has slid from nearly 5.5 million before the recession to 4 million in recent months.[6]

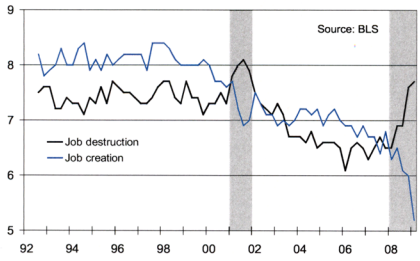
What makes the recent downturn unusual is not the rise in layoffs, but the plunge in hiring. The so-called job destruction rate is somewhat lower today than it was during the height of the 2001 recession, but the job creation rate

[4] Automatic stabilizers are federal programs that automatically adjust without explicit action by Congress or the executive branch. The fiscal stimulus includes temporary tax cuts and spending increases legislated and implemented to cope with the downturn.

[5] This is on a year-over-year basis; productivity did edge a bit lower on a quarterly basis early in the recession. Revisions to GDP, employment, hours and productivity will eventually occur but are still likely to show productivity rising significantly.

[6] This is based on the BLS's jobs opening and turnover survey. Net job growth equals the number of workers hired less the number of layoffs, quits and other separations.

Chart 3: Job Creation Evaporates
Rate of job creation and destruction, %



is much lower (see Chart 3).[7] Judging by the job creation rate, businesses are much less willing to hire than at any time since the BLS began calculating these numbers in the early 1990s. The contrast with the job creation rate during the tech boom of the 1990s is particularly striking.

Job creation has fallen across all industries, although not surprisingly, it has been most pronounced in construction and manufacturing and related industries such as wholesaling and transportation. The decline is also evident across firms of all sizes but has been disproportionately large among very small businesses (those with up to four employees) and very big ones (with more than 1,000 employees). Given the large number of workers in small businesses, about half the decline in job creation has been among firms with fewer than 100 employees; about a fourth has occurred among firms with between 100 and 1,000 employees; and the remaining fourth has involved firms with more than 1,000 employees (see Table 1).

The principal impediment to hiring at smaller businesses appears to be a lack of credit. According to the Federal Reserve's senior loan officer survey, banks are no longer aggressively tightening underwriting standards for loans to small and mid-sized businesses, but standards remain exceptionally tight.[8] This is evident in the credit data, as commercial and industrial loans outstanding continue to fall rapidly, and the number of bank credit cards has plummeted by nearly 90 million, or 25%, since peaking in mid-2008.[9] Most C&I loans go to large businesses, and credit cards go to consumers, but small businesses rely heavily on both loans and credit cards to finance their activities.

Small-business borrowers are also likely being hampered by the plunge in housing and commercial real estate prices. Real estate is often used by small-business owners as collateral for borrowing. With the value of that collateral less certain, lenders are less willing to make loans.

The likely impediment to job creation at large businesses is not credit—the cor-

[7] Job destruction and creation rates, measured as the ratio of layoffs and hires to the labor force, respectively, are from the BLS business employment dynamics survey.

[8] The Fed asks respondents whether they have tightened their underwriting or increased their loan spreads in the last quarter. Recent responses indicate that fewer lenders are tightening further, but there is no indication they have eased after the extreme tightening that occurred this time last year.

[9] It is difficult to disentangle the impact of credit standards and weaker credit demand on credit outstanding, but suffice it to say, standards have arguably never been as stringent.

Table 1: Very Small and Very Big Businesses Account for a Disproportionately Large Share of the Problems in the Job Market

Change between 2009Q1 and 2007, ths

	Job Creation	Job Destruction	Job Creation Less Destruction	Share of Jobs 2007	Share of Job Creation	Share of Job Destruction	Share of Job Creation Less Destruction
TOTAL	-1,648	1157	-2805				
0-49 employees	-649	340	-989	41.5	39.4	29.4	35.3
0-4 employees	***-146***	***92***	***-238***	***6.0***	***8.9***	***8.0***	***8.5***
5-9 employees	*-134*	*39*	*-173*	*8.0*	*8.1*	*3.4*	*6.2*
10-19 employees	*-155*	*67*	*-222*	*10.9*	*9.4*	*5.8*	*7.9*
20-49 employees	*-214*	*142*	*-356*	*16.6*	*13.0*	*12.3*	*12.7*
50-249 employees	-331	318	-649	29.0	20.1	27.5	23.1
50-99 employees	*-151*	*143*	*-294*	*12.9*	*9.2*	*12.4*	*10.5*
100-249 employees	*-180*	*175*	*-355*	*16.0*	*10.9*	*15.1*	*12.7*
Over 500 employees	-670	499	-1169	29.5	40.7	43.1	41.7
250-499 employees	*-119*	*116*	*-235*	*9.2*	*7.2*	*10.0*	*8.4*
500-999 employees	*-104*	*94*	*-198*	*6.9*	*6.3*	*8.1*	*7.1*
Over 1,000 employees	***-447***	***289***	***-736***	***13.4***	***27.1***	***24.9***	***26.2***
0-100 employees	-800	483	-1283	54.5	48.5	41.7	45.7
100-1,000 employees	-403	385	-788	32.1	24.5	33.3	28.1
Over 1,000 employees	-447	289	-736	13.4	27.1	24.9	26.2

Sources: BLS Business Employment Dynamics, Moody's Economy.com

porate bond and commercial paper markets are functioning well—but rather policy uncertainty. Policy changes now being debated in Washington arguably have not been this sweeping since the Great Depression. The most obvious include reforms of healthcare, energy, financial regulation and tax policy. Except for the energy and climate change legislation, all seem likely to produce new laws during the coming year. Each could have enormous implications for businesses; thus, firms are likely holding back on expansion decisions until there is more clarity from Capitol Hill.

The potential of policy to impact job creation is amplified by the ability of large firms to shift activities overseas. Despite big productivity gains and lower labor costs in the U.S., costs and market opportunities in emerging economies are growing in attractiveness.

Uncertainty and indecision among business executives cannot be discounted as a reason for the poor job market. Business surveys broadly show sentiment has improved since this time last year, but it remains extraordinarily fragile (see Chart 4).[10] Many businesses suffered near-death experiences during the recession, and those memories remain fresh.

Job tax break

Given the struggling job market and the threat it poses to the recovery, it is appropriate for policymakers to consider steps to jump-start job creation. At the top of the list is a temporary tax break for firms that increase their payrolls. Businesses may expand payrolls by giving their existing employees more hours, raising wages, and/or hiring more workers. The tax breaks being considered take a number of forms, including reductions in payroll taxes and tax credits for adding and retaining employees.

The principal economic logic behind such a tax break is that temporarily reducing the cost of labor will prod businesses to expand. The time appears increasingly opportune for such an inducement. For businesses to add to their payrolls they must first be confident that there is sufficient demand for whatever their new employees will produce. Demand, as measured by real final sales, has been increasing modestly since the recession ended last summer. Gains in exports have been particularly notable. Policy efforts to shore up demand remain substantial; moreover, federal money could soon fund additional emergency unemployment insurance benefits and increased aid to financially strapped state governments.

Many businesses also need access to credit to finance expansion and increase hiring. While credit remains constrained, particularly to smaller businesses, there are substantial policy efforts underway that should soon bear fruit. The Small Business Administration has been empowered to extend more credit, and substantive changes to the SBA's loan guarantee programs have made them more effective. The Obama administration has also proposed funneling leftover TARP funds to small banks, to enable them to make more small-business loans.

Only when demand is sufficiently strong and credit is ample do businesses focus on the cost of labor and whether it makes sense to add jobs. Demand should be firmer and credit flowing more freely by this summer—just about the time a tax break for hiring would be in full swing.

There are some meaningful downsides to providing tax breaks for hiring. The most obvious is their cost. The proposals

Chart 4: Near-Death Experiences Undermine Animal Spirits
Net % of small businesses planning to increase total employment

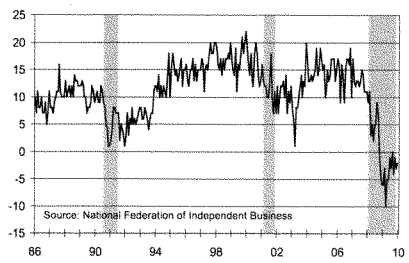


Table 2: Fiscal Stimulus Bang for the Buck

Tax Cuts	Bang for the Buck
Nonrefundable lump-sum tax rebate	1.01
Refundable lump-sum tax rebate	1.22
Temporary tax cuts	
Payroll tax holiday	1.24
Job tax credit	1.30
Across-the-board tax cut	1.02
Accelerated depreciation	0.25
Loss carryback	0.22
Housing tax credit	0.90
Permanent tax cuts	
Extend alternative minimum tax patch	0.51
Make Bush income tax cuts permanent	0.32
Make dividend and capital gains tax cuts permanent	0.37
Cut in corporate tax rate	0.32
Spending Increases	**Bang for the Buck**
Extending unemployment insurance benefits	1.61
Temporary federal financing of work-share programs	1.69
Temporary increase in food stamps	1.74
General aid to state governments	1.41
Increased infrastructure spending	1.57

Note: The bang for the buck is estimated by the one-year dollar change in GDP for a given dollar reduction in federal tax revenue or increase in spending.

Source: Moody's Economy.com

[10] The National Federation of Independent Survey of small businesses, the Conference Board survey, and Business Roundtable surveys of large businesses, and the Moody's Economy.com weekly global business survey all roughly show this.

being debated have upfront costs ranging from approximately $12 billion to $35 billion. The ultimate costs—after accounting for the additional tax revenues and lower government spending from a better job market and stronger economy—are lower. Still, unless these costs are covered, they will add to the nation's already-daunting long-term fiscal problems. It is worth noting that the bang-for-the-buck from a job tax break—the increase in real GDP per dollar of budgetary cost—is the highest among various tax cuts often considered as part of the fiscal stimulus (see Table 2).

Job tax breaks are also not particularly efficient, in that most firms that receive the benefit would arguably have increased their payrolls without it. It probably is not a bad thing to provide a boost to these businesses, as they likely are the engines of job growth, but the number of jobs directly created because of firms' temporarily lower taxes is modest.

Another potentially serious problem is the potential for gaming by businesses. It is difficult for policymakers to anticipate all the ways businesses might take unintended or inappropriate advantage of a job tax break. Various safeguards can be put in place to mitigate this, but the tighter the safeguards, the more complex the process becomes, reducing businesses' participation and thus the number of jobs ultimately created.

Yet weighing all the potential pluses and minuses, a job tax break still seems a worthwhile policy effort at this point in the recovery. A well-designed and appropriately sized tax break will measurably raise the odds that hiring will revive in earnest and that the recovery will evolve into a self-sustaining economic expansion by this time next year.

The Obama plan

The Obama plan, known as the "Small Business Jobs and Wages Tax Cut," provides a credit of up to $5,000 to be applied against a firm's payroll taxes for each net new employee hired in 2010. The credit is available for all businesses, regardless of their size, and new startup firms may claim a credit of up to $2,500.

Small businesses, defined as firms with fewer than 50 employees, would also not be required to pay their 6.2% share of Social Security payroll taxes on wage increases above the rate of inflation. This benefit is based on Social Security payrolls and would thus not apply to wage increases above the current taxable maximum of $106,800.

The credit would be claimed quarterly by businesses and the total tax benefit per business would be capped at $500,000. Nonprofit organizations would be eligible but state and local governments would not.

The upfront cost of the Obama plan is estimated at $33 billion (see Table 3).[11] At its peak employment impact, reached at the end of 2010, the plan would add close to 725,000 jobs.[12] The upfront cost per additional employee, a measure of its efficiency, is also the lowest among the plans at $45,500. After accounting for the increase in other tax revenues and lower government spending resulting from the plan's impact on broader economic activity, the ultimate cost per additional employee is $36,400. It is the most cost efficient of the plans, although differences among the plans are modest and within the margin of error involved in making such estimates.

The Obama plan's ability to spur additional job growth is enhanced by the size of the tax credit for adding workers. This is a substantial incentive to businesses to add jobs rather than give existing workers more hours or raise wages. With hours worked near a record low, businesses have a strong incentive to increase hours rather than employment. Providing nonprofits and startups with a tax break also increases the plan's reach and the number of jobs created.

Another nice feature, common to all of the proposals, is allowing businesses to claim part of the credit each quarter instead of waiting to file annual tax returns. Businesses will appreciate the quick cash to defray some of their hiring and other costs.

Limiting the job creation potential of the Obama plan is its $500,000 cap on the tax break per business. The intent is to limit the plan's cost, to ensure that smaller businesses are able to receive much of the benefit, and to guard against some forms of gaming; but the cap also limits the plan's efficacy. The plan is also relatively complex, reducing its job impact, but as such, it is also the best at dealing with potential abuse by businesses.

The Casey-Gillibrand plan

The Casey-Gillibrand plan, "Job Creation Tax Credit," provides a credit against payroll taxes equal to 20% of the increase in payroll costs for small firms with less than 100 employees. Large firms would receive a 15% credit but only if they have at least a 3% increase in payroll over the past year. To claim the credit firms must have more employees than they did in the same quarter in the prior year. The credit is based on Social Security payrolls and thus does not apply to wage increases above the current taxable maximum of $106,800.

As in the Obama plan, the credit would be claimed quarterly by businesses, but the total tax benefit per business would be capped at a lower $350,000. The credit is nonrefundable which means that nonprofits and state and local governments are not eligible for the credit.

[11] This cost estimate is very similar to the administration's own estimate of the plan's cost.
[12] The job tax benefit is assumed to begin in April 2010 for all of the plans considered in this analysis.

Table 3: Employment Impact and Cost of Job Tax Break Proposals

	Maximum Additional Jobs	Upfront Cost	Upfront Cost Per Employee	Ultimate Cost Per Employee
Obama	726,532	33,049,800,000	45,490	36,392
Schumer/Hatch	249,600	11,678,120,000	46,787	43,980
Casey/Gillibrand	667,277	35,088,000,000	52,584	43,119

Source: Moody's Economy.com

The upfront cost of the Casey plan is estimated at $35 billion, and its peak employment impact early in 2011 is 670,000 additional jobs. The upfront cost per additional job is thus $52,600 and its ultimate cost per additional job after accounting for the impact of a stronger economy on tax revenues and government spending is $43,100.

The Casey plan's most significant advantage is the size of the tax credit, which is the largest of the proposals. The tax savings to businesses are large enough that it should get their attention and encourage widespread and quick participation. Enhancing the plan's impact is that more than half of employment is in firms with fewer than 100 employees that get the large 20% credit.

The plan is also relatively straightforward and can be easily implemented by businesses, but does not appear to be vulnerable to serious abuse. It is also the friendliest of the plans towards smaller businesses.

The Casey plan's job impact is reduced because it does not provide an explicit incentive for businesses to add jobs. Only firms that add to or at least maintain their payrolls qualify for the credit, but with so many workers already on reduced hours, firms have a strong incentive to extend their hours before hiring more employees. The relatively low dollar cap on businesses and the exclusion of nonprofits also limit the plan's reach.

The Schumer-Hatch plan

The Schumer-Hatch plan, the "Hire Now Tax Cut," is the simplest and most straightforward of the proposals. It is effectively a payroll tax holiday, equal to 6.2% of payroll costs, for all workers hired in 2010 who have been unemployed at least 60 days. Businesses of all sizes are eligible for the tax benefit, as are nonprofits; state and local governments are not. Since businesses would simply not have to pay their portion of new workers' payroll taxes, they would benefit immediately. The Schumer plan also includes a retention bonus equal to $1,000 for each new worker still employed a year after they were hired.

The Schumer plan is significantly less expensive than the other proposals, with an estimated upfront cost of about $12 billion. Largely reflecting the plan's smaller size, the maximum employment impact is 250,000 additional jobs. The peak employment impact would likely occur a few months earlier than the other plans, as the value of the tax benefit to businesses will be very small during the last months of the year. The upfront cost per additional job comes in at $46,800, and its ultimate cost per additional job is $44,000.

The Schumer proposal's biggest advantage is its simplicity. There are no constraints on eligibility, and the plan is easy to explain—no employer payroll taxes on unemployed workers in 2010. This may bring rapid and broad participation by businesses. The restriction that firms must hire unemployed workers also has the clear advantage of targeting the most disadvantaged.

The plan's simplicity does increase the chance of abuse. Unemployed workers would have to sign affidavits saying they had been unemployed more than two months, yet there would be no formal oversight. Employers could also replace current employees with unemployed workers at a lower cost. Although this would be prohibited, the plan contains no formal enforcement mechanism. Targeting the unemployed could also slow or even reduce hiring, since it could be difficult to match open positions with the skills and education of the unemployed in some industries and regions.

A Suggestion

Any tax cut plan's success will be determined by how much more rapidly businesses hire than would have been the case without the tax benefit. One way to accelerate businesses' response would be to cap the dollar amount of the program, and provide it to those firms that hire first. First come, first serve worked particularly well for the cash-for-clunkers program: vehicle buyers were given a reason to act quickly or lose the tax break. Funding was quickly exhausted as vehicle sales soared last fall.

The same principle could be used for the job tax cut. Using the Obama proposal as a framework, suppose the government committed $25 billion to a plan offering a $5,000 credit against payroll taxes paid on any net new employee hired in 2010. Or use the Schumer idea to focus the tax break to benefit the unemployed: the plan would provide a credit of up to $7,000 for any new hire of a previously unemployed worker. The credit would be payable quarterly and the total tax benefit per business would be capped at $500,000. Nonprofit organizations would be eligible but state and local governments would not. The tax benefits would be provided until the $25 billion was used up.

Businesses would have to hire quickly or lose the opportunity for a tax benefit. Hesitant firms would have a reason to put aside their concerns and hire. Aside from accelerating job creation, an advantage of the plan would be that less of the $25 billion would go to firms that would have hired anyway. The peak employment impact under this plan would occur in the third quarter of this year, when an additional 615,000 jobs would be created. The upfront cost per employee would be $41,000 and the ultimate net cost $36,000. This plan would thus create jobs somewhat more quickly than the other plans being considered, at a somewhat lower cost.

Conclusions

If history is a guide, job growth should resume this spring. Positive signs point this way: Initial claims for unemployment insurance have fallen significantly, temporary hiring is up, weekly hours worked are off the bottom, and various business surveys suggest firms are more open to expanding payrolls. With the government set to create more than a million temp jobs to conduct the 2010 Census, it is hard to believe job growth will not resume soon.

Yet there are reasons to be nervous that hiring will not revive in earnest, and may even peter out after the census is finished this summer. A lack of credit, particularly among small businesses, and a loss of confidence across all businesses threaten to short-circuit the job machine.

With a jobs revival and full economic recovery not assured, policymakers are rightly focused on providing further support to the economy. Fiscal policymakers are contemplating a bill to jump-start hiring. This legislation would boost credit to small businesses, infrastructure spending, and public service and summer youth jobs. A jobs tax break, which would lower the cost of adding to firms' payrolls, is also being considered. A tax break for hiring could be particularly effective this summer. By then, businesses will have had more time to come to terms with the Great Recession, and banks should be extending credit somewhat more freely by then.

While the recovery is likely to slowly gain traction even without more help from policymakers, the odds remain uncomfortably high—about one in four—that it will not. And if the economy backtracks into recession, unemployment will surge, igniting a vicious deflationary cycle that even

more aggressive action by the Fed would have difficulty breaking. The fiscal outlook would quickly become untenable. Providing a bit more policy help this year to avoid this very dark scenario seems worth the cost.

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PROMOTING JOB CREATION IN THE UNITED STATES

TUESDAY, SEPTEMBER 20, 2011

COMMITTEE ON THE BUDGET,
U.S. SENATE,
Washington, DC.

The Committee met, pursuant to notice, at 9:32 a.m., in Room SD–608, Dirksen Senate Office Building, Hon. Kent Conrad, Chairman of the Committee, presiding.

Present: Senators Conrad, Wyden, Nelson, Whitehouse, Warner, Merkley, Begich, Sessions, and Ayotte.

Staff Present: Mary Ann Naylor, Majority Staff Director; and Marcus Peacock, Minority Staff Director.

OPENING STATEMENT OF CHAIRMAN CONRAD

Chairman CONRAD. The hearing will come to order.

I want to welcome everyone to the Senate Budget Committee today. Today we will again focus on the economy and additional steps that can be taken to strengthen the recovery and to create jobs.

We are fortunate to have three distinguished witnesses here today.

Dr. Alice Rivlin, of course, is well known to this Committee and has testified here many times. She currently serves as director of Greater Washington Research at the Brookings Institution as well as co-chair of the Bipartisan Policy Center's Debt Reduction Task Force. She was the founding Director of the Congressional Budget Office, served as Director of the Office of Management and Budget in the Clinton administration and held the position of Vice Chair of the Federal Reserve. She also served with me last year as a member of the President's Fiscal Commission. I can attest to the extraordinary contribution she made there. Dr. Rivlin is truly a giant in the budget world. We are delighted that she can be with us today.

Dr. Harry Holzer is Professor of Public Policy at Georgetown University. Dr. Holzer served as the Chief Economist at the Labor Department during the Clinton administration. We are delighted that you could be here as well.

And Dr. J.D. Foster is a senior fellow in the economics of fiscal policy at the Heritage Foundation. Dr. Foster served as Assistant Director for Economic Policy at the Office of Management and Budget during the George W. Bush administration, and I understand he will be here shortly.

Thank you all. We look forward to your testimony.

I would like to just begin by putting things in perspective, and I want to begin with a brief overview of the economic situation as I see it.

It is important to remember what has happened to the economy. In January of 2009, the economy was losing more than 800,000 private sector jobs a month. Private sector jobs growth returned in March of 2010, and we have now had 18 consecutive months of growth. However, in August we gained only 17,000 private sector jobs, which is clearly not enough. We face a very real threat of going back into recession. That is why I believe we need to take steps to generate near-term economic growth and jobs while we simultaneously address the long-term debt threat.

The unemployment rate remains far too high. As of August, the unemployment rate was 9.1 percent, and long-term unemployment is up sharply. In August long-term unemployment, those unemployed for 27 weeks or longer, was 3.9 percent. That is up dramatically from the 0.8 percent average over the period from 1948 to 2007.

The median duration of unemployment is also up sharply, climbing to almost 22 weeks in August. We know that some of the drag holding back the recovery is caused by the nature of the recession that preceded it. Economists have found that following recessions that were caused by or accompanied by a severe financial crisis, the recoveries tend to be shallower and take much longer. Two leading economists, the two Reinharts—Dr. Carmen Reinhart and Dr. Vincent Reinhart—found in their research, and I quote: "Real per capita GDP growth rates are significantly lower during the decade following severe financial crises. . . . In the 10-year window following severe financial crises, unemployment rates are significantly higher than in the decade that preceded the crisis."

"The decade of relative prosperity prior to the fall was importantly fueled by an expansion of credit and rising leverage that spans about 10 years; it is followed by a lengthy period of retrenchment that most often only begins after the crisis and lasts almost as long as the credit surge."

We also know the Federal response to the recession and financial crisis helped to pull the economy back from the brink and made the recovery stronger than it would have been without it.

One of our witnesses last week, Dr. Mark Zandi, along with Dr. Alan Blinder, a former Vice Chairman of the Federal Reserve, completed a study last year that measured the impact of Federal actions to shore up the economy, including both the Fed's monetary policy actions and the fiscal actions taken by the Congress and the administration. Here is a quote from their report:

"We find that its effects"—"it" being the Federal response—"on real GDP, jobs, and inflation are huge and probably averted what could have been called 'Great Depression 2.0.' When all is said and done, the financial and fiscal policies will have cost taxpayers a substantial sum, but not nearly as much as most had feared and not nearly as much as if policymakers had not acted at all. If the comprehensive policy responses saved the economy from another depression, as we estimate, they were well worth their cost."

This chart, the next chart, shows Dr. Zandi and Dr. Blinder's estimate of the number of jobs we would have had without the Fed-

eral response. It shows we would have 8 million fewer jobs in the second quarter of 2010 if we had not had the Federal response.

We see a similar picture in the unemployment rate. If we had not had the Federal response, the unemployment rate would have been 15 percent in the second quarter of 2010 and would have continued rising to 16.2 percent in the fourth quarter of 2010—this, again, according to Zandi and Blinder.

In addition to helping create jobs, it is also worth noting the importance of the 2009 Recovery Act in strengthening the Nation's social safety net. According to an analysis of Census Bureau data, unemployment benefits kept 3.2 million people out of poverty in 2010. Medicaid and CHIP expansions ensured half a million fewer children were uninsured in 2010 than in 2007. SNAP, formerly known as food stamps, kept 3.9 million people out of poverty in 2010. And the earned income tax credit kept 5.4 million people out of poverty in 2010.

I hope our witnesses can comment on the importance of these programs and their impact on the recovery.

With that, we will turn to Senator Sessions for his opening remarks, and then we will turn to our witnesses for their testimony.

OPENING STATEMENT OF SENATOR SESSIONS

Senator SESSIONS. Thank you, Chairman Conrad, for holding this hearing. I think it is helpful for us to meet and continue to discuss these issues, although we are not working on a budget, unfortunately.

And thank you, Dr. Rivlin, for all you have done for your country and for being with us again today, and thank you, Dr. Holzer and Dr. Foster, for joining us to share your insights.

I know Dr. Zandi is a good man and he insisted that we have a stimulus plan and demanded that we have one, and we got one and it did not do what he predicted, and now he says if it had not passed, it would all have been a disaster. I am not unaware of the fact that Dr. Zandi, as capable as he is, in January of this year predicted we would have 3.9-percent economic growth this year, and the first quarter came in at 0.4 and the second quarter at 1.0 and now his prediction has dropped to 1.6, a stunning reversal of his prediction.

So I guess I would just say, Mr. Chairman, that when you are running up unprecedented debt, it is easy to say we borrow and spend and it is going to create growth, but it did not create much growth, that is for sure—not as much as Dr. Zandi and others predicted.

But there is one thing we can agree on, I think: that we are suffering from unacceptably and persistently high unemployment. Millions are unable to find jobs. Millions are unable to find jobs on a full-time basis, that are now working part-time. Our economy has experienced anemic growth this year and unexpectedly high unemployment this year. America's gross debt is rising to dangerous new levels.

I do, however, have a confident feeling about our future. I believe that if we meet the challenges of our current crisis, we will struggle, but we will rise from it with a renewed vibrancy and strength. No workforce on Earth is more skilled, more productive, or dy-

namic than the American workforce. No business community is more effective. No nation can compete with the men and women that make up this economy. That is as true today as it ever was, and there are some indications that if we do things right, we may take back our production of manufacturing that America has lost in past years.

America's private sector is just waiting to grow and expand, but unwise Government policy continues to stand in the way. Unpredictable Federal intervention is fostering a climate of fear and uncertainty. Businesses are threatened with a constant slew of new taxes and regulations, and America's gross debt, now 100 percent of GDP, hangs over the economy like a dark gray cloud.

A prominent study praised by Secretary Geithner indicates that our debt at the debt level today already costs us growth and jobs. We need policies that create a better environment for job creation and ones that do not add to the debt. That means more American energy production, the elimination of harmful and costly regulations and growth-oriented tax reform.

All three Committee witnesses last week, Democrat and Republican, agree with the wisdom of those ideas. Since taking office, President Obama has surged our gross Federal debt nearly $5 trillion in 3 years. Non-defense discretionary spending spiked 24 percent during the first 2 years of his Presidency, and his February budget called for further dramatic increases in discretionary spending next year, increases, double digit.

For instance, he has requested a 13-percent increase in education spending following an almost 70-percent increase in total education spending since taking office.

The President routinely talks about the need to make Government investments—i.e., spending—but he forgets to mention just how much we have already spent. Yesterday he made his fourth attempt this year to offer a credible fiscal vision, but I was disappointed to see he again failed to present the honest budget plan America deserves and our economy needs.

The White House says that the President's plan achieves $3.2 trillion in deficit reduction. The actual deficit reduction is only $1.4 trillion, less than half of what the White House states. Note this is $1.4 trillion in deficit reduction, not spending reduction, even the 1.4 that is achieved. This has become the pattern. The President understates the depth of our fiscal danger and overstates the impact of his plans.

Consider the astounding disparity between the levels of taxation claimed versus those actually contained in the proposal. The White House asserts $2 in cuts for every $1 in tax hikes. The true figure is nowhere close to that. The President's plan is compromised of tax hikes alone. In reality, there is not a single penny of net spending that is cut. Yesterday the President said this: "I am proposing real serious cuts in spending. When you include the $1 trillion in cuts that I have already signed into law, these would be among the biggest cuts in spending in our history."

In reality, under the President's plan the net change in spending is an increase. In fact, the President's plan is to keep spending more. Part of this is a result of the President's new stimulus jobs

program. But there are three additional accounting tricks that the White House used to get these inflated figures.

First, war funding. The plan shows $1.1 trillion in savings from putting a cap on war costs, but those costs are going to decrease as the war effort unwinds whether or not there are caps in place. They do not represent actual spending cuts from what we project or a new policy to achieve future savings. The President's proposed caps simply manipulate baseline concepts to show the savings as a policy choice, which inflates the spending cuts in the President's plans. Congress rightly rejected this accounting process as part of the deficit reduction during our recent debate.

The doc fix. The administration's baseline also assumes a Medicare doc fix, which is the payment for our physicians, an increase in spending of $293 billion over 10 years compared to the current baseline. This gimmick accounts for the higher spending as a given rather than as a policy choice that needs to be offset. Without this gimmick, the President's health care savings of $320 billion becomes a health care savings of only $27 billion.

Interest savings. The President counts as savings the net interest reductions that result from his proposed tax hikes, counts that as a spending cut. When you are in a crisis, you must deal honestly with the American people. A President, more than anyone, has to have credibility with the American people. You must present the facts with credible solutions.

Americans are good, decent, hard-working people who will accept a difficult course of action on honest terms, but the White House is trying to be clever at the expense of being credible. The debt is destroying jobs today, and if we are going to restore confidence and growth, credibility is one asset we cannot afford to borrow against.

America deserves an honest, fact-based approach to our economic challenges, one that controls Washington spending and grows the private sector. I hope today's hearing will move us in that direction.

Thank you, Mr. Chairman, for leading us and calling us together and this good panel of witnesses.

Chairman CONRAD. Thank you, Senator Sessions.

Obviously, we do not have complete agreement on this panel. [Laughter.]

You know, we certainly disagree as to how we got here. I do not think the current administration created this problem. They inherited it. They inherited an economy that was on the brink of financial collapse, and we were brought to the brink of collapse by the set of policies that I see being repeated by our friends on the opposite side. Those are the same nostrums they offered before that brought us to the brink of financial collapse:

Do not have regulation on the big financial institutions. That is what led to the collapse of the financial sector.

Do not regulate derivatives. We saw what happened. AIG, biggest insurance company in the world, failed, had to be taken over during the Bush administration.

And the debt skyrocketed as a result of those failed policies. If tax cuts that disproportionately benefit the wealthy were the answer, we would have had a booming economy at the end of the Bush administration. Instead, we were on the brink of financial col-

lapse. I was in the room when the Secretary of the Treasury in the Bush administration came to tell the leadership of Congress, Republican and Democrat, that if they did not take over AIG the next morning, there would be a financial collapse within days. Barack Obama was not the President. George W. Bush was the President.

So the place we do agree is we have a debt threat that must be confronted. It must be confronted. This is the place we do agree. And we have got to find a way to come together to both deal with the short-term crisis we confront in terms of one in every six Americans being unemployed or underemployed and the harsh reality that we have a debt that is too high, that is growing too fast, and must be dealt with.

So that is where we are.

Senator SESSIONS. Mr. Chairman.

Chairman CONRAD. Senator Sessions.

Senator SESSIONS. There is much truth in what you say. I remember you hammering President Bush with your charts week after week on the floor for overspending while, in effect, our Democratic colleagues were simultaneously criticizing the Republicans for not spending enough. But we did put our country at risk, and decisions were not correct over a period of years, including the Democratic blocking of President Bush's request to have more regulations of Freddie and Fannie. Had that been done earlier on, we may not have had anything like the serious problem we have. So the regulations were proposed by Senator Shelby, my colleague, passed out of the Committee on a party-line vote, but blocked on the floor.

But that is all—you are correct. We have got to now focus on the future. And I just would say to you I believe my statement was hard this morning, but I believe it was correct in holding the President accountable for presenting now a fourth plan that does not seriously address our problem. It is essentially a plan to raise taxes on a weak economy, and as Dr. Hassett said previously in our previous hearing, it would take—we may be going a long time without very slow growth, and these costs of spending now to borrow will come to roost before our economy has come back. And that is a dangerous path.

So thank you for having this hearing, and I appreciate your leadership.

Senator WYDEN. Mr. Chairman.

Chairman CONRAD. Senator Wyden.

Senator WYDEN. Could I take under 1 minute? Because the Finance Committee is going to a markup, but I just wanted to offer one quick thought because I think it can help bring us together.

Chairman CONRAD. Yes.

Senator WYDEN. And Mr. Foster is here, and he is with the Heritage Association. Mr. Foster, I am not sure you are aware, but Heritage scored our tax reform bill, the legislation I have had with Senator Gregg and now with Senator Coats. Here are the numbers: Heritage said that bill would create 2.3 million more jobs per year, increase disposable income by $4,100 per year for a family of four, raise foreign investment in the United States by $292 billion a year on average, and boost real GDP by an average of $298 billion per year.

I only offer this up because I have listened to this kind of discussion. We have a chance for bipartisanship here. Senator Warner in particular and Senator Chambliss have done some very good work. Ms. Rivlin has done some very good work. I am going to try to get back, Mr. Chairman. I just wanted to bring that up because I continue to believe that we can come together, particularly around growth-oriented tax reform, and do it in a bipartisan way.

Thank you for this courtesy, and I apologize to my colleagues for imposing.

Senator SESSIONS. Mr. Chairman, Senator Wyden has truly worked hard on a complex piece of legislation that has the potential for bipartisan support and does have some very fine parts of it. I congratulate you, Senator Wyden, for trying to come up with some ideas that can make this country better.

Chairman CONRAD. Well, I thank Senator Sessions for that observation. I would add my voice. Actually, this effort, as Senator Sessions knows, started with Senator Gregg, who was the Ranking Republican on this Committee. He and Senator Wyden worked together in a very collaborative and intense effort to look at the Tax Code, which is a monstrosity by anyone's definition. And we appreciate the work.

Let us go to the witnesses. Alice Rivlin really needs no introduction before this Committee. Welcome. Please proceed.

STATEMENT OF THE HONORABLE ALICE M. RIVLIN, PH.D., DIRECTOR, GREATER WASHINGTON RESEARCH, THE BROOKINGS INSTITUTION

Hon. RIVLIN. Thank you, Mr. Chairman, Senator Sessions, and members of the Committee. I am delighted to be back here, and I want to reinforce what has been said, that there is a chance for bipartisan cooperation now, and I hope the Congress seizes it.

This is a critical moment for this Committee to focus on employment and job creation and for the Congress to take action. The future of the United States as a prosperous economy and as a world power depends on getting people back to work in productive jobs. Unless employment accelerates sufficiently to keep up with the natural increase in the labor force and gradually absorb the unemployed and the hidden labor force of discouraged and part-time workers, we are doomed to stagnation and eroding standards of living.

This fate is not necessary. We have jobs that need to be done in both the public and the private sectors and millions of people who want to do them. It would be unbelievably stupid to allow capacity to sit idle—workers skills to atrophy and workplaces to become museums of out of-date technology—for lack of imagination and political will.

However, policies to accelerate job growth and prevent a double-dip recession must be part of a simultaneous strategy to stabilize the projected increases in national debt and return the Federal budget to a fiscally responsible path. Rather than conflicting, these two sets of policies complement and reinforce each other. The faster we get people back to work, the easier it will be to move toward a sustainable budget. If the recovery stalls and unemployment rises again, prospects for stabilizing the debt will deteriorate rapidly. It

will be worth some temporary increase in the near-term deficit to avoid getting into another downward spiral of falling jobs, sales, investment, and confidence. At the same time, the faster we can put a firm plan in place to reduce looming future deficits—by reforming entitlements and the Tax Code to enhance incentives for growth—the more sustainable the recovery will be. We cannot afford to wait until the economy recovers before acting to rein in future deficits. These deficits reflect the oncoming tsunami of retirees combined with rising health care costs. They cannot be blamed on President Obama or President Bush. The sooner we put fixes in place—either on the spending or on the tax side—the less disruptive these changes will have to be.

If we continue postponing actions to stabilize the debt, we undermine the confidence at home and abroad in the ability of our political system to face problems and solve them. We risk a spike in interest rates and even a sovereign debt crisis that could permanently damage the power and prosperity of the United States.

No one should underestimate the difficulty of crafting policies that will effectively create jobs in the peculiarly daunting economic circumstances that we face. It will take the best efforts of the public and private sectors working together plus cooperation and compromise across party and ideological lines—which is hard to achieve in the current polarized political atmosphere.

The recession is deeper and more intractable than most economists—including those in the Obama administration, including Mark Zandi, and almost all the other economists I know—realized at the time that employment and incomes were plummeting in 2008 and 2009. Recessions precipitated by financial crises tend to be deep and long, as scholars like the Reinharts have shown, but this one is likely to be especially hard to pull out of quickly. It was precipitated by an uncontrolled and, I believe, immoral frenzy of overleveraged trading in complex derivatives based on unrealistic expectations of continued value increases in the very assets that American households depend on most—their homes. After the plunge in those overinflated values, we should not be surprised that confidence is low and consumers and the businesses that depend on them are deeply frightened of being overextended.

The large stimulus package enacted in early 2009 helped keep the economy from sliding into an even deeper recession. I do not know whether the Zandi-Blinder numbers are exactly right, but we surely would have had millions more people out of work if we had not done something. Together with aggressive monetary policy, the stimulus helped reverse the downward spiral of falling demand and layoffs. The Congressional Budget Office and many other analysts have clearly shown that the economy performed substantially better than it likely would have in the absence of the fast and aggressive administration and congressional action. That growth, though positive, has been modest and unemployment remains high is evidence of the depth and intractable nature of the recession, not that the stimulus did not work.

But the events of the last year have shown that more action is needed. Just as the direct impact of the stimulus began running out, additional negative forces hit the economy—the rising energy prices, the effects of the Japanese nuclear disaster, slowing growth

in the rest of the world, and worrisome disarray in Europe. The President is absolutely right, I believe, to propose a new package of tax cut extensions with incentives to boost employment, help for the long-term unemployed, and infrastructure investment. This package was carefully designed to incorporate many policies that appeal to both parties. It includes a proposal to redesign unemployment compensation to facilitate getting workers into jobs. I believe this Congress should take the proposal seriously, but incorporate it into a longer-run deficit plan, as the President suggests.

Any action to create jobs right now, whether through spending or tax cuts—will increase the deficit and add to the debt. But we can afford to do this if the immediate actions are part of a legislative package that stabilizes the debt by reforming and simplifying the personal and corporate Tax Codes, reducing the rate of growth of Medicare and Medicaid, and putting Social Security on a firm foundation. Variations of such a "grand bargain" were recommended by the Simpson-Bowles Commission and the Domenici-Rivlin Task Force. Indeed, any serious bipartisan group seeking to stabilize the debt is forced by the arithmetic of the situation to a similar solution. The President's speech yesterday voiced his clear commitment to the double strategy of creating jobs and reining in future deficits.

The new Joint Select Committee, which I think of as Conrad-Gregg come to real life, has the power to go beyond its initial mandate and make the grand bargain a legislative reality. The best thing that could happen to prospects for American growth and jobs—both long and short run—would be for this Committee with the strong support of the President and congressional leadership to "go big" and use their extraordinary powers to put into law an immediate job creation program incorporated into a grand bargain to stabilize the debt.

Mr. Chairman, you and your former colleague, Senator Judd Gregg, and many others worked tirelessly to get the Congress and the President to this point. I earnestly hope the Select Committee will prove able to finish the job.

Thank you.

[The prepared statement of Hon. Rivlin follows:]

"Employment, Growth, and the Budget"

Testimony of Alice M. Rivlin*

The Brookings Institution and Georgetown University

Senate Budget Committee

September 20, 2011

Mr. Chairman and members of the Committee:

This is a critical moment for this Committee to focus on employment and job creation and for the Congress to take action. The future of the United States as a prosperous economy and as a world power depends on getting people back to work in productive jobs. Unless employment growth accelerates sufficiently to keep up with the natural increase in the labor force and gradually absorb the unemployed and the hidden labor force of discouraged workers, we are doomed to stagnation and eroding standards of living. This fate is not necessary. We have jobs that need to be done in both the public and private sectors and millions of people who want to do them. It would be unbelievably stupid to allow capacity to sit idle--workers skills to atrophy and work-places to become museums of out-of-date technology—for lack of imagination and political will.

However, policies to accelerate job growth and prevent a double dip recession must be part of a simultaneous strategy to stabilize the projected increases in national debt and return the federal budget to a fiscally responsible path. Rather than conflicting, these two sets of policies complement and reinforce each other. The faster we get people back to work, the easier it will be to move toward a sustainable budget. If the recovery stalls and unemployment rises again, prospects for stabilizing the debt will deteriorate rapidly. It will be worth some temporary increase in the near-term deficit to avoid getting into another downward spiral of falling jobs, sales, investment and confidence. At the same time, the faster we can put in place a firm plan to reduce looming future deficits—by reforming entitlements and the tax code to enhance incentives for growth—the more

*Alice M. Rivlin is a Senior Fellow at the Brookings Institution and a Visiting Professor at Georgetown University. The views expressed in this statement are strictly her own and do not necessarily reflect those of staff members, officers, or trustees of the Brookings Institution or Georgetown University.

sustainable a stronger recovery will be. We cannot afford to wait until the economy recovers before acting to rein in the future deficits. These deficits reflect the on-coming tsunami of retirees combined with rising health care costs. The sooner we put fixes in place (either on the spending or tax side) the less disruptive these changes will have to be. If we continue postponing actions to stabilize the debt, we undermine the confidence at home and abroad in the ability of our political system to face problems and solver them. We risk a spike in interest rates and even a sovereign debt crisis that could permanently damage the power and prosperity of the United States.

Creating Jobs and Strengthening Recovery

No one should underestimate the difficulty of crafting policies that will effectively create jobs in the peculiarly daunting economic circumstances we face. It will take the best efforts of the public and private sectors working together plus cooperation and compromise across party and ideological lines—which is hard to achieve in the current polarized political atmosphere.

This recession is deeper and more intractable than most economists—including those in the Obama Administration and other national and global institutions—realized at the time employment and incomes plummeted in late 2008 and early 2009. Recessions precipitated by financial crises tend to be deep and long, as scholars have shown, but this one is likely to be especially hard to pull out of quickly. It was precipitated by an uncontrolled, immoral frenzy of overleveraged trading in complex derivatives based on unrealistic expectations of continuous value increases in the very assets that American households depend on most, their homes. After the plunge in those over-inflated values, we should not be surprised that confidence is low and consumers and the businesses that depend on them are deeply frightened of being over-extended.

The large stimulus package enacted in early 2009 helped keep the economy from sliding into an even deeper recession. Millions of jobs were created or preserved. Together with aggressive monetary policy, the stimulus helped reverse the downward spiral of falling demand and layoffs. CBO and other analysts have clearly shown that the economy

performed substantially better than it likely would have in the absence of the fast and aggressive administration and congressional action. That growth, though positive, has been modest and unemployment remains high is evidence of the depth and intractable nature of the recession, not that the stimulus "didn't work."

But the events of the last year have shown that more action is needed. Just as the direct impact of the stimulus began running out, additional negative forces hit the economy—rising energy prices, the effects of the Japanese nuclear disaster, slowing growth in the rest of the world, and worrisome disarray in Europe. The President is absolutely right to propose a new package of tax cut extensions with incentives to boost employment, help for the long-term unemployed, and infrastructure investment. This package was carefully designed to incorporate many policies that appeal to both parties. It includes a proposal to redesign unemployment compensation to facilitate getting workers into jobs or training, not just to extend their benefits. Congress should take the President's proposal as the basis for serious work with the White House to craft a bipartisan legislative package that will contribute to both short- and long term job growth and serve as insurance against another economic downturn.

The JSC: Unique Opportunity for a "Grand Bargain"

Won't any action to create jobs—whether through spending or tax cuts—increase the deficit and add to the debt? Yes, of course, but we can afford to do that if the immediate actions are part of a legislative package that stabilizes the debt by reforming and simplifying the personal and corporate tax codes, reducing the rate of growth of Medicare and Medicaid, and putting Social Security on a firm foundation. Variations of such a "grand bargain" were recommended by the Simpson Bowles Commission and the Domenici Rivlin Task Force. Indeed, any serious bipartisan group seeking to stabilize the debt is forced by the arithmetic of the situation to a similar solution. The President's speech yesterday voiced his clear commitment to the double strategy of creating jobs and reining in future deficits.

The new Joint Select Committee has the power to go beyond its initial mandate and make the grand bargain a legislative reality. The best thing that could happen to prospects for American growth and jobs—both long and short-run--would be for the JSC with the strong support of the President and Congressional leadership to "go big" and use their extraordinary powers to put into law an immediate jobs program incorporated into a "grand bargain" designed to stabilize the debt.

Mr. Chairman, you and your former colleague, Senator Judd Gregg, and many others worked tirelessly to get the Congress and the President to this point. I earnestly hope the Joint Select Committee will prove able to finish the job.

Thank you, Mr. Chairman and members of the Committee.

Chairman CONRAD. Thank you, Dr. Rivlin.
Dr. Holzer.

STATEMENT OF HARRY J. HOLZER, PH.D., PROFESSOR OF PUBLIC POLICY, GEORGETOWN UNIVERSITY

Dr. HOLZER. Thank you. Good morning, Chairman Conrad, Senator Sessions, and Senator Warner. I would like to make several points this morning about the unemployment rate and also about the U.S. labor market situation over the next several years, and I would like to make five broad points, if I may.

Point number one, as we all know, the Great Recession has created very high unemployment that will persist for several years to come and will have lasting negative impacts on millions of workers, even after the economy recovers. As Senator Conrad pointed out, over 40 percent of the unemployed already suffer lengthy spells of unemployment, 6 months or longer, which will make it harder for them to re-enter the job market and find jobs when job creation actually picks up. And low earnings will scar millions of young workers for years to come, even when the labor market recovers.

But, point number two, even before the recession began, most American workers suffered from stagnant earnings growth and very high earnings inequality. During the full economic cycle of 2000 to 2007, median earnings stagnated or declined for most groups of American workers. Many of those hit hardest during the downturn, like less-educated men, were actually faring quite badly even before the recess began because of declining real earnings. Disadvantaged workers more broadly suffer not only from high unemployment but also from low wages and limited labor market activity, even when the economy is strong. Among many other problems, the education and skill levels of many of these workers have failed to keep pace with the rising demand for skills in good-paying jobs in our economy.

Point number three, policy efforts to improve labor market outcomes for American workers should focus both on creating jobs and reducing unemployment caused by the recession in the near term, as well as on improving the skills and earnings of American workers over the long term. To create more jobs and reduce unemployment, I support many of the provisions of the American Jobs Act, including reduced payroll taxes for workers, targeted payroll tax cuts for employers who are expanding payrolls, and additional spending on infrastructure, school construction, and layoff prevention of State and local government employees.

Personally, I would prefer the tax cuts for employers to be more generous than those proposed by the Obama administration, but at the same time much more targeted on employers whose payrolls are actually expanding, because this would improve incentives to expand hiring and limit the windfall for employers who do not change their behavior and pocket the tax cuts anyway.

But at the same time, we also need to take actions to improve the education and workforce preparation of American workers so that they are more able to fill good-paying jobs, and that leads me to my fourth point.

To improve worker skills, we need to develop more effective education and workforce systems, better targeted towards growing and

high-paying sectors of the U.S. economy. Earnings supplements for disadvantaged and dislocated workers who are actually taking low-wage jobs could also be expanded while the unemployment insurance system could be more closely tied to skill-building efforts.

If I could just take a minute to elaborate on those proposals, the current workforce system, funded by the Workforce Investment Act, appears to generate employment services and job training quite cost-effectively, but it has been starved for funds for many years and should not be further reduced in the context of budget-cutting efforts. But we also need to better integrate career services and occupational training in our high schools and in our colleges, and to make both sets of institutions more responsive to the demand side of the labor market. For high schools, this means generating high-quality career and technical education—not as a substitute for higher education but as another means of preparing students for higher education and the labor market. Career Academies have demonstrated the value of such education, especially for at-risk young men.

Turning to American colleges, most students who attend community colleges never complete any educational credential, which I define either as an occupational certificate or an associate's degree; and when they do, the credentials they do get too often are not in fields that are well rewarded in the labor market. So career counseling and other support services need to be improved at these schools, and remedial education needs to be better integrated with actual occupational training. The colleges themselves should face stronger incentives, in the form of per capita funding from their States, to expand curricula and instructional capacity in areas where labor demand is strong and growing, and that is often not the case right now.

Rigorous evaluation shows that sectoral training, in which young or adult workers are prepared for specific sectors of the economy and in which employers are actively engaged, can provide strong earnings improvements for the disadvantaged while meeting employer needs for skilled workers. These programs can and should be especially supportive of employers who take the high road and provide good-paying jobs for less-educated workers. Dislocated workers, including the long-term unemployed, can also derive substantial benefit from technical training targeted towards growing fields of the economy.

Now, I believe all of this could be supported by a new competitive grants program provided to the States that more actively integrate their education and workforce systems and make them more responsive to the labor market, and especially the needs of good-paying employers, along the lines I have described. This program should actively reward States for building on their efforts to date and leveraging many other sources of funding. But any new funding should not become yet another excuse to cut back funding for existing WIA programs.

For disadvantaged workers or dislocated workers who do not benefit from training, supplements to their low earnings could be expanded. These would include the earned income tax credit, which right now benefits adults without children too little, or also wage insurance for the dislocated who have taken lower-wage jobs than

the ones they held before. And I believe a variety of reforms in the unemployment insurance system might encourage more employers and more training to be provided to these workers.

Finally, my last point, which actually deals with the budget issue, all of these measures could be undertaken with modest new Federal expenditures over time. They are not inconsistent with sensible efforts to limit our budget deficits over the long run, which should primarily focus on raising Federal tax revenues below its historically low level right now and reducing spending on entitlement programs, especially for future retirees. That is where I think the bulk of the long-term savings on the budget side should be made.

So thank you. I will stop there and look forward to our question-and-answer session.

[The prepared statement of Dr. Holzer follows:]

Testimony Before the Budget Committee of the United States Senate

Harry J. Holzer, Professor of Public Policy, Georgetown University

September 20, 2011

I would like to make the following points this morning about unemployment and the U.S. labor market situation over the next several years.

1. **The Great Recession has created very high unemployment rates that will likely persist for several years to come and have lasting negative impacts on millions of workers.**

Over 40 percent of the unemployed suffer from lengthy spells of unemployment (i.e., longer than six months), which will make it harder for them to reenter the job market and find employment when job creation picks up. And low earnings will scar millions of young workers for years to come, even when the labor market fully recovers.[1]

2. **But, even before the recession began, most American workers suffered from stagnant earnings growth and very high earnings inequality**.

During the full economic cycle of 2000-2007, median earnings stagnated or declined for most groups of workers. Many of those hit hardest during the downturn (such as less-educated men) were faring quite badly even before it began.[2] Disadvantaged workers more broadly suffer not only from high unemployment rates but also from low wages and limited labor force activity, even when the economy is strong.[3] Among many other problems, the education and skill levels of many of these workers have not kept pace with the rising demand for such skills in good-paying jobs.

3. **Policy efforts to improve labor market outcomes for American workers should focus both on creating jobs and reducing unemployment caused by the recession in the near term, as well as on improving the skill levels and earnings of Americans over the longer term**.

To create more jobs and reduce unemployment, I support many of the provisions of the American Jobs Act, including reduced payroll taxes for workers, more targeted payroll tax cuts for employers who are expanding payrolls, and additional spending on infrastructure, school

[1] See, for instance, Kahn (2009) or von Wachter (2010).
[2] See Holzer and Hlavac (2010).
[3] Labor force participation rates of high school dropouts in America typically are below 50 percent. Among other groups, like black teenagers, participation rates are generally below 30 percent, and many become "disconnected" from both school and the labor force at very early ages (Edelman et al., 2006).

construction, and layoff prevention of state and local government employees.[4] But we should also take actions to improve the education levels and workforce preparation of American workers, and their ability to fill good-paying jobs.

4. **To improve worker skills, we need to develop more effective education and workforce development systems that are better targeted towards growing and high-paying sectors of the U.S. economy. Earnings supplements for disadvantaged and dislocated workers could also be expanded, and be more closely tied to skill-building.**

The current workforce development system, funded by the Workforce Investment Act, appears to generate employment services and job training quite cost-effectively, but it has been starved for funds for many years and should not be further reduced.[5]

But we also need to better integrate career services and occupational training in our high schools and colleges, and make both sets of institutions more responsive to the demand side of the labor market. For high schools, this means generating high-quality career and technical education – not as a substitute for higher education but as another possible means of preparing for it as well as the labor market. The Career Academies have demonstrated the value of such education, especially for at-risk young men.[6]

Most students who attend community colleges never complete an educational credential, defined as either a training certificate or an associate's degree; and, when they do, the credentials too often are not in fields that are well-rewarded in the labor market. Career counseling services need to be improved at these schools, and remedial education needs to be better integrated with occupational training.[7] The colleges themselves should also face stronger incentives, in the form of per-capita funding from their states, to expand their curricula and instructional capacity in areas of strong and growing labor market demand.[8]

Rigorous evaluation evidence shows that *sectoral* training, in which young or adult workers are prepared for specific sectors of the economy and in which employers are actively engaged, can

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[4] I personally would prefer payroll tax cuts for employers to be much more generous than those proposed by the Obama Administration, and much more exclusively targeted to employers whose payrolls are expanding. This would greatly increase employer incentives to expand hiring and limit the extent to which such tax credits are "windfalls" for employers who do not change their behavior.

[5] See Heinrich et al. (2009) and Heinrich and King (2010). A recent report by the USGAO (2011) indicates that there are dozens of workforce programs and suggests some duplication of effort across programs; but, in reality, the vast majority of these programs are very small and targeted at very specific populations. In a labor market where such services and training are generally underfunded, and too low to meet potential demand for such services, the existence of multiple programs does not necessarily indicate wasteful duplication.

[6] See Kemple (2008) and Symonds et al. (2011).

[7] The Integrated Basic Education and Skill Training (I-BEST) program in the state of Washington is one example of an effort to better integrate remedial and occupational training.

[8] See Jacobson and Mokher (2009), Soares (2010), and Holzer and Nightingale (2009).

provide strong earnings improvements for disadvantaged workers while also meeting employer needs for skilled workers.[9] These programs can and should be especially supportive of employers who create good-paying jobs for less-educated workers.[10] Dislocated workers can also derive substantial benefits from more technical training targeted towards growing fields.[11]

I believe that a new competitive grants program should be provided to states that more actively integrate their education and workforce systems and make them more responsive to labor market demand, and especially the needs of good-paying employers, along the lines I describe above. This program should actively reward states for building on their efforts to date and leveraging other sources of funding.[12] But any such new funding should not become yet another excuse to reduce funding for WIA programs.

For disadvantaged or dislocated workers who might not benefit from such training, earnings supplements should be expanded. These can include the Earned Income Tax Credit (EITC), which currently benefits adults without (custody of) children very little, or wage insurance for the dislocated who have taken lower-wage jobs than they held before. A variety of reforms in the Unemployment Insurance (UI) system might also encourage more training or employment.[13]

5. **All of these measures could be undertaken with modest new federal expenditures over time. They are not inconsistent with sensible efforts to limit our budget deficits over the long-run, which should primarily focus on raising federal tax revenues and reducing spending on entitlement programs, especially for future retirees.**

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[9] See Maguire et al. (2010) and Roder and Elliott (2011).

[10] In other words, technical assistance or tax credits might specifically be provided to employers that take the "high road" in their human resources policies and provide career ladders and promotion opportunities for entry-level employees. Other efforts to improve job quality, such as collective bargaining and minimum wage laws, should also continue to play some role as well.

[11] See Jacobson et al. (2003).

[12] The details of my proposal will be available in a paper that will be published by the Hamilton Project at the Brookings Institution in October 2011.

[13] See Edelman et al. (2009) for proposals to expand the EITC, particularly for childless adults. Reforms in the UI system might make it easier for workers to gain extensions of UI while they are training for jobs at accredited institutions, while wage insurance proposals would reward workers for accepting low-wage jobs after losing better-paying ones.

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Chairman CONRAD. Excellent testimony. Thank you very much. Dr. Foster.

STATEMENT OF J.D. FOSTER, PH.D., NORMAN B. TURE SENIOR FELLOW IN THE ECONOMICS OF FISCAL POLICY, THE HERITAGE FOUNDATION

Dr. FOSTER. Chairman Conrad, Ranking Member Sessions, thank you for the opportunity to testify today. My name is J.D. Foster. I am a senior fellow at The Heritage Foundation. The views I express are my own and should not be construed as representing any official position of The Heritage Foundation.

The risks to the economy today are great, and so our focus on jobs and economic growth is critical. Two years after the end of the Great Recession, as the economy should be accelerating, economic growth and job growth have ground to a halt.

Mr. Chairman, as you noted, when a recession is fundamentally involved with financial markets and they are troubled, they are the epicenter of the recession, you are going to have a very troubled recovery. Absolutely correct. But you will have recovery. Two years on, we should be in recovery—not flat-lining, not heading toward a double dip, possibly. So while financial markets may explain the early troubles of the recovery, I do not believe they provide much of an explanation for today.

Speculation, argumentation, theorizing, and models are now irrelevant on this simple point. The data before us agree on the underlying message from the President's recent jobs speech. They all attest to the simple, incontrovertible fact that the President's stimulus policies have failed utterly and completely. I take no pleasure in pointing out this fact, nor in the fact that we predicted the policy failure 2 years ago. I would much rather have been wrong and for millions of my fellow citizens to be gainfully employed in all those jobs the President promised to create.

To understand what policies might be helpful today and which harmful, it is important to assess why the economy is not recovering. The fundamentals of our economy remain sound. The natural productive tendencies of America's workers, investors, and entrepreneurs remain undiminished. The economy is poised to grow. Why, then, does it hold back?

There are, of course, the unusual head winds, such as the follow-on effects of Japan's devastating earthquake and tsunami. But the economy faces and overcomes such head winds even in the best of times. Head winds there are, to be sure, but they are not an explanation of the economy's lethargy.

The economy suffers from two categories of troubles. The first are structural, which today primarily reflect a housing sector still in deep disequilibrium in many areas of the country. There is very little substantively that Government can do to return housing markets to normal, and heaven knows Congress and the President have tried just about everything. And that is part of the problem. Government's well-intentioned meddling has delayed and distorted the essential requirement for normalization of the housing markets—price discovery. On balance, these policies have set back the housing recovery by months, perhaps a year or more, and there is an important lesson there.

The second category of trouble is what might be termed "environmental"—not the natural environment but the economic environment. Most relevant for our discussion today is alternatively a shortage of confidence or an excess of bad uncertainty.

Those who could make the decisions and take the actions that would grow the economy lack the confidence to do so. Even today, the economy abounds in opportunities for growth. But turning potential into reality requires action, and action requires confidence—confidence in the future, confidence in the specific effects in Government policy, and confidence that Government can properly carry out its basic functions, like agreeing to a budget. America suffers a confidence shortage, and Washington is overwhelmingly the cause.

Confidence, in turn, is lacking because of an excess of uncertainty: uncertainty about the future, but also uncertainty about the effects of Government policies—tax, regulatory, monetary, trade. Uncertainty is natural, of course. The future is always uncertain. But there is good uncertainty and bad uncertainty, much as there is good cholesterol and bad cholesterol. Good uncertainty, for example, presents opportunities for profit. Bad uncertainty arises largely when investors and entrepreneurs have very real questions about the consequences of Government policy.

Tax policy provides a good example of bad uncertainty. The President's repeated insistence on raising taxes on high-income workers and investors slows the economy without the policy even being enacted. It does so by raising the uncertainty about the tax consequences of various actions. It does not stop all such actions, but it stops some, and therein lies the difference between growth and stagnation.

The President's insistence is a two-fer in terms of bad uncertainty. The specific is that taxpayers do not know what their tax liability will be. The general is that suggesting raising taxes on anyone in the face of high and possibly rising unemployment suggests a gross lack of understanding about how an economy works. That is a source of bad uncertainty that afflicts the entire economy, not just those threatened with higher taxes. In this environment, Congress need not enact bad policy to weaken the economy. Threats suffice.

The Federal Government should adopt a very simple guiding principle for deciding what to do next. That principle is: Do less harm. Do less harm. There is very little in terms of concrete actions Government can do at this stage that would help, and a great deal of intended help that would harm, either by raising the deficit to no good effect or by creating more uncertainty and slowing the economy's natural healing process. Do less harm means getting spending under control and thereby cutting the budget deficit. Americans are worried about spending and the deficit. That worry by itself is debilitating.

Do less harm means policymakers should stop threatening higher taxes. We can have debates about who should pay what and how much when we are at full employment. In the meantime, this threat is holding us back.

Do less harm means stop the onslaught of new regulations. The recent pullback of the EPA's ozone regulation was a good example.

Even the threat of new regulations creates bad uncertainty for those affected, freezing them in place. Again, we can work through these regulations when Americans are back to work.

Do less harm means policymakers should stop meddling with the economy. There is almost no limit to the harm Washington can do to the economy in its efforts to do something for the economy. The patient is in recovery—a difficult recovery, to be sure, but in recovery—slowed by the incessant proddings and procedures of Washington's policy doctors. The patient does not need another procedure or a new nostrum. Let it heal. Do less harm.

Let me talk briefly about one philosophy that has been driving a lot of our policy, the model of Keynesian demand management. This is a perfect example of a policy that fails do less harm. The philosophy is very simple. The economy is underperforming; demand is too low; the Government budget deficit is a component of demand, so just raise it. It is an equation. How can it be wrong? Raise Government deficit spending and the economy should recover.

The reason this fails is the economy is a little more complicated than a simple equation. The model that it is based on ignores something else in the economy, a process called "financial intermediation," basic function of financial markets.

The problem is that when Government runs more deficit spending, it has to borrow the money. When it borrows the money, that money is not available to the private sector to use. So you have not increased total demand. All you have done is shifted around.

Now, advocates for this policy will say, ah, yes, but there is so much saving and people are not doing anything with it; corporations are sitting on the money. Well, yes, they are, but that is not at issue. They do not put it in vaults. They do not stuff it in mattresses. They make it available to the financial system, which then intermediates it to those who need it.

This Keynesian stimulus cannot work. It is fiscal alchemy, and it is adding to the head winds in the economy. This is a perfect example of a policy that fails do less harm.

Thank you, Mr. Chairman.

[The prepared statement of Dr. Foster follows:]

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CONGRESSIONAL TESTIMONY

Promoting Job Creation in the U.S.

Testimony before
The Committee on the Budget
United States Senate

September 20, 2011

J.D. Foster, Ph.D.
Norman B. Ture Senior Fellow in the Economics of Fiscal Policy
The Heritage Foundation

Chairman Conrad, Ranking Member Sessions, Members of the Senate Budget Committee, thank you for the opportunity to testify today. My name is J.D. Foster. I am the Norman B. Ture Senior Fellow in the Economics of Fiscal Policy at The Heritage Foundation. The views I express in this testimony are my own, and should not be construed as representing any official position of The Heritage Foundation.

The risks to the economy are great, and so the focus today on jobs and economic growth is critical. Two years after the end of the Great Recession, as the economy should be accelerating smartly, economic growth and job growth have ground to a halt. Speculation, argumentation, theorizing, and models are now irrelevant on this point – the data before us agree with the underlying message from the President's recent jobs speech. They all attest to the simple, incontrovertible fact that the President's stimulus policies have failed utterly and completely. I take no pleasure in pointing out this inescapable reality, nor in the fact that we predicted this policy failure two years ago. I would much rather have been wrong, and for millions of my fellow citizens to be gainfully employed in all those jobs the President promised to create.

Nor is the worst necessarily behind us. Left to our own, I believe the economy would pick up soon despite, not because of, the President's policies. But we will not be left to our own. Europe is about to go through a cataclysmic paroxysm as it suffers the inevitable penalty of a failed monetary system. We are about to learn, once again, how important Europe is to the United States as Europe's troubles present us with the stark reality of a certain, large, near-term and a still larger medium-term economic shock only the exact proportions of which remain uncertain.

To understand what policies might be helpful today and which harmful, it's important to assess why the economy is not yet recovering. The fundamentals of our economy remain sound. The natural productive tendencies of America's workers, investors, and entrepreneurs remain undiminished. The economy is poised to grow. Why, then, does it hold back?

There are, of course, the unusual headwinds, such as the follow-on effects of Japan's devastating earthquake and tsunami. But the economy faces and overcomes such headwinds even in the best of times. Headwinds there are, to be sure, but they do not explain the economy's lethargy.

The economy suffers from two categories of troubles. The first are structural troubles, which today primarily reflect a housing sector still in deep disequilibrium in many areas of the country. There is very little substantively that government can do to return housing markets to normal, and heaven knows Congress and the President have tried just about everything. And that is part of the problem. Government's well-intentioned meddling has delayed and distorted the essential requirement for normalization – price discovery. On balance, these policies have set back the housing recovery by months, perhaps a year or more. There is an important lesson here.

The second category of trouble is what might be termed environmental -- not the natural environment, but the economic environment. Missing from most economics textbooks are the true animating forces of prosperity. Most relevant for our discussion is alternatively a shortage of confidence or an excess of bad uncertainty.

Those who could make the decisions and take the actions that would grow the economy lack the confidence to do so. Even today, the economy abounds in opportunities for growth. But turning potential into reality requires action, and action requires confidence—confidence in the future, confidence in the specific effects in government policy, and confidence that government can properly carry out its basic functions, like agreeing to a budget. America suffers a confidence shortage, and Washington is overwhelmingly the cause.

Confidence, in turn, is lacking because of an excess of uncertainty: Uncertainty about the future, but also uncertainty about the effects of government policies – tax policies, regulatory policies, monetary policies, trade policies.

Uncertainty is natural, of course. The future is always uncertain. But there is good uncertainty and bad uncertainty, much as there is good cholesterol and bad cholesterol. Good uncertainty, for example, presents opportunities for profit. Bad uncertainty arises largely when investors and entrepreneurs have very real questions about the consequences of government policy.

Tax policy provides a good example of bad uncertainty. The President's repeated insistence on raising taxes on high-income workers and investors slows the economy even without the policy being enacted. It does so by raising the uncertainty about the tax consequences of various actions. It does not stop all such actions, but it stops some, and therein lies the difference between growth and stagnation.

Moreover, the President's insistence is a twofer in terms of bad uncertainty. The specific is that taxpayers don't know what their tax liability will be. The general is that suggesting raising taxes on anyone in the face of high and possibly rising unemployment suggests a gross lack of understanding about how an economy works. That's a source of bad uncertainty that afflicts the entire economy, not just those threatened with higher taxes. In this environment, Congress need not enact bad policy to weaken the economy. Threats suffice to do real damage.

Guiding Principle: Do Less Harm

The federal government should adopt a very simple guiding principle for deciding what to do next. That principle is to do less harm. There is very little in terms of concrete actions government can do at this stage that would help, and a great deal of intended help that would harm, either by raising the deficit to no good effect or by creating more uncertainty and slowing the economy's natural healing process.

Do less harm means getting spending under control and thereby cutting the budget deficit. Americans are worried about spending and the deficit. That worry by itself is holding us back.

Do less harm means policymakers should stop threatening higher taxes. We can have debates about who should pay what when we're at full employment. In the meantime, this threat is debilitating.

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uncertainty for those affected, freezing them in place. Again, we can work through these regulations when Americans are back to work.

Do less harm means policymakers should stop meddling with the economy. There is almost no limit to the harm Washington can do *to* the economy in its efforts to do something *for* the economy. The patient is in recovery, slowed by the incessant proddings and procedures of Washington's policy doctors. The patient doesn't need another procedure or a new nostrum. Let it heal. Do less harm.

Keynesian Alchemy

What policies meet this criterion? Under the circumstances, very few. Consider, for example, the policy of increasing the budget deficit to spur the economy. The argument is fairly simple: the economy is underperforming; demand is too low; the government deficit is part of aggregate demand, so just increase the deficit. It's an equation. How can it be wrong?

The answer, of course, is that the economy is more complicated than this simple equation. Government borrows the money, so every deficit dollar spent by the government is a dollar less available to the private sector. The answer, in other words, is that the macroeconomic model ignores financial intermediation which is the bread and butter of financial markets.

Proponents will counter by saying that people are saving more, and corporations are sitting on mounds of cash. True, but it changes nothing. All this saving is not lying dormant in some vault or stuffed in some mattress. Ironically, even if it were, irresponsible deficit spending would surely not draw it out. On the contrary, this saving is deposited with the financial system, which then takes the resources from those who do not currently need them and makes them available to those who do need them. In terms of aggregate flows, this process works just as well today in recession as it does at full employment.

Thus, Keynesian demand-side stimulus does not help. It is fiscal alchemy. And by adding to the deficit and thus fears about the future, it surely adds to the economy's headwinds.

Infrastructure

Increased infrastructure spending, as the President and others have advocated, is an example of a double folly. To be clear, the issue here is not whether the nation needs more or less infrastructure spending. I am not expressing an opinion on that one way or another.

The issue is whether it acts as a short-term stimulus. It does not. First, assuming the additional spending was financed by additional borrowing, the policy runs afoul of the Keynesian fallacy. To be sure, once a project is underway one can point to the people working, but just as surely the borrowing that made that project possible reduced employment elsewhere.

The second folly is just as plain. Infrastructure spending on projects is capital intensive and stretches over years. It cannot, even if enacted, swiftly affect employment in the next year plus.

Payroll Tax Holiday

The irony of another payroll tax holiday to create jobs is that reducing payroll taxes would increase employment when the economy is at full employment yet cannot accelerate hiring in periods of high unemployment. The key to this irony is incidence – who bears the tax.

The payroll tax is borne by workers. It subtracts from their total compensation, leaving them less after-tax wage income. This is equally true of the "employer's share," because, of course, the employer has no share. The tax is all paid by the worker, but the worker unfortunately is aware of only half the tax, so extending the tax relief to the invisible part of the tax does not improve the outcome. Nor are weak labor markets the environment in which workers would gain a new ability to force employers to bear part of the tax.

Thus, a reduction in the payroll tax rate does not reduce the employer's costs, but rather raises the worker's after-tax wage. During periods of full employment, this means an additional supply of workers to be absorbed into the economy, thereby raising output. During periods of high unemployment, the increase in labor supply resulting from a payroll tax cut, temporary or otherwise, results in an increase in the number of unemployed workers. Thus, a policy intended to reduce the ranks of the unemployed is likely to produce an increase in the unemployment rate.

Repatriation Tax Holiday

Another policy under consideration that does not create jobs is a repatriation tax holiday. The issue here is not whether tax cuts are good or bad per se, but whether this particular tax cut would increase domestic employment and domestic jobs. Again, the answer is that it would not.

A repatriation tax holiday would result in a sizable influx of corporate profits from abroad. Tax policy does matter. Companies do respond to this extent. But no new jobs would result. The key to understanding why this policy and its undoubted influx of capital would not increase investment and jobs at home lies in the following question: Are these repatriating companies capital-constrained today?

No, they are not. These large multinational companies have enormous sums of accumulated earnings parked in the financial markets already. And those few if any that might need additional financing have ready access to the capital markets at remarkably low prices. Thus, they can meet all their financing needs out of available domestic resources. Adding to those resources will not increase the extent of their investment opportunities. Parallel to the payroll tax holiday that would increase the supply of workers without increasing the number of jobs available, the repatriation tax holiday would increase the supply of saving without increasing the range or amount of investments to which the saving could be applied.

Unemployment Benefits

Yet another ineffective or even counterproductive policy for increasing employment is extension of unemployment benefits. This policy may be defended on humanitarian grounds, but not as economic stimulus because it, too, runs afoul of the Keynesian fallacy. The extension of benefits will certainly increase the purchasing power and purchases of the recipients, but the borrowing needed to fund these benefits will with equal certainty reduce other areas of private spending.

Further, to the extent the resulting increased budget deficit adds to the depth of the bad uncertainty, it adds to this important economic headwind. And the research on the issue strongly suggests, as recent papers by both the Heritage Foundation and the Brookings Institution made clear, that extending unemployment benefits actually raises the unemployment rate.

Conclusion

In light of the ongoing high unemployment, policymakers should be keenly focused on what they can do for the economy. But they must also recognize the limitations of policy initiatives. As difficult as this may be to implement, the guiding principle should be: Do less harm.

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Chairman CONRAD. Thank you.

We are going to go to Senator Warner for the first round of questioning because he has got other obligations, as do—I would say to our witnesses, this is a morning in which other committees on which Budget Committee members serve have markups, and so you are going to see Senators come and go to accommodate that. I know Senator Warner has other obligations as well, as does Senator Sessions.

Senator Warner.

Senator WARNER. Thank you, Mr. Chairman. Thank you for that courtesy, and I would like to thank the panel. A couple of quick questions.

One, while we have a diversity of views on the panel, I think in a traditional approach we would normally say in periods of enormous recession that the two major tools that a national government has are monetary policy and fiscal stimulus. And we can gauge how effective they have both been, but we basically use both of those bullets. And I am curious. One thing I have not heard any of the witnesses quantify, and from across the spectrum, is, as someone who like the Chairman and others has been working on and feels very strongly about deficit reduction and debt reduction, the added cost to the debt of a stagnant economy. Have we been able to equate per point of increased unemployment what that translates into in terms of lost tax revenue, additional mandatory Government spending in terms of unemployment insurance, Medicaid, other Government support programs, so that while, you know, some would advocate immediate cuts regardless of effect, if we bump up an extra point or two of unemployment, what direct effect does that have on the current deficit?

Hon. RIVLIN. Well, higher unemployment and less growth clearly cuts into tax revenue and adds to costs in programs like unemployment compensation. The CBO and others have done that calculation. I do not have the numbers at my fingertips, but they are not hard to find.

Senator WARNER. Does anybody have that number just as a kind off-their-head ballpark number?

Dr. HOLZER. I do not have the exact number, but I do know that people have looked at the growth of the debt over time, attribute a good part of that growth not to the specific policy choices we have made since 2008 but, in fact, to the recession and automatic declines in tax revenues and automatic increases in spending programs that do not reflect any choices that we have made, but that has added likely several billion dollars—trillion dollars, I am sorry, to the current level of debt. And that likely could swamp—if the economy double dips, that could swamp any other efforts made by the super committee to trim the deficits by further reducing tax revenues and raising spending.

Senator WARNER. Dr. Foster.

Dr. FOSTER. Yes, Senator. This is one of those rare moments when we are all in agreement, which is rather pleasant. To add to what Dr. Rivlin said, there is a chapter in the Analytical Perspectives of the President's Budget—it has been in there for many years—in which there is a table. I believe it is Chapter 3, perhaps Table 3.11, which goes through a budget sensitivity analysis, and

you can see in there various divergences of economic performance from the President's economic assumptions and the consequences for revenues and outlays over 10 years. So while I do not have the numbers, I can tell you at least where you might be able to find them.

Senator WARNER. It all makes logical sense. It would be nice, though, to be able to have that as kind of one of our normal talking points that per point of unemployment growth or per half-point of lack of GDP growth, how that adds to the deficit.

I guess, Dr. Foster, there are two things. I understand your perspective and your concern about kind of the "do no harm" theory. Would that "do no harm" theory in terms of the revenue side also apply to the immediate Government spending side? Would not immediate cuts at this moment in time with the verge of a double dip in front of us also fall into that category of harming the economy?

Dr. FOSTER. In general, I do not believe so, Senator, because I believe that the Government spending which is being funded by borrowing is simply moving demand around in our economy. It is crowding out, in the old expression, certain other spendings.

Now, if you quickly switch from a form of spending where the economy has productive capacity built up to deal with that spending, like defense spending, where we have defense contractors who are geared up to produce certain weapons systems, if suddenly you cut them off obviously that is going to require transition costs to the economy. But, otherwise, no, I do not believe reducing the spending would be harmful, in fact, there is so much concern about the deficit and debt that that is one of the factors eroding confidence or building up bad uncertainty in the economy, and it is what is holding us back. So not only would we not suffer a downside to such a policy, but there would be an actual gain to the economy by reducing the uncertainty.

Senator WARNER. But are you saying that transformation in terms of cutting defense spending might be bad, but cutting State support of infrastructure or teachers or others would not be bad or would not have any ill effect?

Dr. FOSTER. No. The point I am trying to make is some would have transitory effects that would be harmful and others would not. Defense is a simple example because you have often large investments to produce a new aircraft, for example. It is fairly easy to understand that there would be transition costs from cutting that back.

There are others as well where you have the private economy that is geared for a customer—the Federal Government. If the Federal Government suddenly cuts off that customer, there is going to be a transition cost. But purchase of goods and services is a relatively small portion of Federal spending. There is an awful lot of other Federal spending that would not be subject to that limitation.

Senator WARNER. So purchase of goods and services, cutting off would be bad, but cutting off direct employment would not be?

Dr. FOSTER. That would not have that transitional effect. That is correct.

Senator WARNER. One of the other things I was questioning is, you know, I concur with your point that capital that is sitting on the sidelines, you know, does not simply sit in a vault. It is in-

vested. But I would question in terms of particularly with record-low interest rates and a lack of willingness to invest that there are more productive uses of this corporate capital than investing in T-bills in terms of generating job growth, generating investment, taking greater risk with larger rewards. You know, I am not sure I would fully——

Dr. FOSTER. Oh, there is no doubt that there would be more productive areas, and I am sure corporate America would love to deploy its vast resources of cash sitting on the sidelines more productively. They lack the opportunity to do so right now with the current economic environment. It gets back to we have a poorly performing economy and a very uncertain future, and so they are sitting on the sidelines.

That is not to say that you are going to get a better outcome simply because Government puts its hands on it and decides to spend it itself.

Senator WARNER. Let me just ask one—I will take one last question since the Chairman was kind enough to give me the time, and I would love to hear Dr. Rivlin and Dr. Holzer comment.

I generally agree with some of your prescriptions. The one thing that I am cautious about is it seems like most of even what the President has proposed, there are very few things that are going to give as immediate a short-term burst. I completely concur with you, Dr. Holzer, on some of the training initiatives, but I constantly see so much of what we try to do up here as well intentioned, the lag time to where it actually has an effect on immediate job growth or spurs really takes much longer than I would like, but both, please—and again, my thanks to the Chairman.

Hon. RIVLIN. Well, just a brief comment. I believe what is holding back investment is not crowding out by the Federal borrowing but lack of demand, and possibly some uncertainty, but lack of demand is the basic problem. If you do not think you can sell your product, you are not going to make more of it. And the way to increase demand in the short run is to get money into people's pockets who will spend it. That is the argument for extending and increasing the payroll tax cut. It goes to wage earners all over the country. They will not spend all of it because they are trying to repair their balance sheets, but they will spend some of it, and that is a way to get demand up.

Dr. HOLZER. I think that there are efforts along the lines of the American Jobs Act, which may not generate jobs tomorrow, but we are looking at the rest of this decade, potentially, just having very stagnant growth, insufficient demand. I think a lot of those proposals—for instance, the payroll tax cut targeted towards employers—and, again, I would target it much more on employers expanding payroll. I think that could actually raise hiring, even at this level of demand, relatively quickly—not enormously but in a cost effective way.

I think some of the spending proposals like preventing the layoff of more State and local employees—that has put a huge drag on the economy and on the employment growth numbers, and I think that could occur relatively quickly as well. So I think within a reasonable time frame many of these policies could be effective, and also cost-effective.

I want to take issue with my colleagues' analysis.

This notion that Government spending has a one-for-one crowding-out effect on private spending, especially in really severe recessions, is not a new idea. This has been debated for 70, 80 years by my profession. I think most economists in this kind of economy would not subscribe to that point of view. Most economists would not read the evidence as supporting that point of view. And, indeed, many conservative economists, Republican economists, like my former teacher, Martin Feldstein, and also economists like Greg Mankiw, do not subscribe to that point of view. So I think we should put those opinions in perspective as very much a minority viewpoint within our profession.

Senator WARNER. Thank you.

Chairman CONRAD. Senator Whitehouse.

Senator WHITEHOUSE. Thank you very much, Mr. Chairman.

As some of you who have been here before, I take a very keen interest in the burden that our health care system lays on our economy. The President's Council of Economic Advisers says you could take $700 billion a year in cost out of the health care system without harming anybody's quality of care. The Lewin Group, which is pretty well regarded in this area, and George Bush's Treasury Secretary, Secretary O'Neill, who knows a fair amount about this from his work in the Pittsburgh Regional Health Initiative, and as the CEO of Alcoa, they both have agreed that it is actually $1 trillion a year that you could take out of our health care costs. That would have significant effect on reducing the cost of Medicare, Medicaid, TRICARE.

The other day Secretary Gates said that his budget is "being eaten alive" by health care costs. It would have, I think, a very significant lift on American exports, which now carry a huge health care cost in their pricing, which our European competitors and some other foreign competitors dodge by having a national health care system and a tax system that exports dodge because they are not picked up in the VAT tax method. And that creates a huge differential, a huge competitive burden on an American export product compared to a competitive product exported into the same international market.

And so it is frustrating to me when we have a panel of experts who talk about our economy and nobody talks about health care. And when we have had this discussion before, what everybody has said is, well, that may be true, but because of the nature of the reforms that are required to begin to unload those excess costs, the 18 percent versus 12 percent of GDP differential that we carry as a load in our health care economy, because the nature of the reforms is something that is, to use a word that only would matter in Washington, "unscorable," we are not going to look at that.

That was true of Bowles-Simpson. I believe that was also true of Domenici-Rivlin. It strikes me that that is a fairly big piece of this equation, and I understand that it does not lend itself to economic analysis as an input, and it is impossible to score because it is a process of innovation and learning and trial and error and experimentation. But, clearly, there is a huge gain to be made just from the difference between where we are as a country and where all

of our competitors are. And as I said, there is bipartisan agreement on that subject.

So I guess I just—you know, I keep sending up a flare whenever we do one of these hearings, saying, for God's sake, can we please consider health care costs, and particularly delivery system reform, which is the way you deal with health care costs without harming some individual who is depending on a particular benefit. So I would love to hear your reaction to that thought, Ms. Rivlin, Dr. Holzer, and Dr. Foster.

Hon. RIVLIN. Thank you. As you know, Senator Whitehouse, I agree with you that the rising health care costs are a huge part of the problem. I talk about this almost every day—not always in 8 minutes. But it is clear that it is the major health care programs that are driving the future budget deficits, and that we, compared to our competitors or to other advanced countries, spend a lot more on health care per patient, per anything. Now, that is partly——

Senator WHITEHOUSE. For relatively crummy outcomes.

Hon. RIVLIN. With relatively crummy outcomes. That is all right.

Now, with respect to what to do about it, I think the problem is not just that we know what to do but it is not scorable, but lots of things that look promising, such as many of the pilot programs and experiments with different payment systems and so forth that are included in the Affordable Care Act, have not shown clearly that they deliver lower costs and better quality.

Now, the way we handled that in the Domenici-Rivlin plan was we did propose a major restructuring of Medicare, known as "premium support," which is a defined contribution plan coupled with competition on exchanges among health plans. This is not vouchers. And we think that gets better outcomes in the long run from the competition among the health plans, but the scorability is in the defined contribution that you can say that unless health care costs come down—well, in any case, the Federal Government will be—its contribution will be defined by the Congress. And once you do that, it is perfectly scorable.

Now, it does not mean you can never change it. Congress could change it anytime they wanted to. But I do think there is an advantage in getting Medicare onto a defined budget that you vote on and you know what it is.

Senator WHITEHOUSE. We are down below 2 minutes, Dr. Holzer. I apologize to you and Dr. Foster.

Dr. HOLZER. Well, I will just say very briefly, in terms of how these things impact on the labor market, not only do the high health care costs impose a cost on employers, which makes it harder for them to hire more workers, but one of the ways they deal with that is to take it out of workers' paychecks.

Senator WHITEHOUSE. Salaries, yes.

Dr. HOLZER. Ultimately, workers bear most of those costs. And, indeed, I think as much as one-half of productivity growth in the previous decade might have been eaten up by rising health care costs in the U.S. It is one of the major reasons why very high productivity growth did not show up in the paychecks of American workers. So I agree with you. It is an enormous problem affecting many dimensions of these issues.

My sense—and I defer to Alice Rivlin who knows much more about this than I do, but I saw a lot of promising efforts to reduce health care costs during the debate on the President's health care package that politically seemed very unpalatable, things like rethinking the very favorable tax treatment, at least putting some caps on that favorable tax treatment of health benefits. And I think we are going to have to return—we might have to sort of face some much harder choices in the future if we want to get those costs under control.

Senator WHITEHOUSE. Dr. Foster.

Dr. FOSTER. Yes, this is another one of those happy moments when we are in basic agreement. There is no question that the rising health care costs are taking the biggest bite out of workers' paychecks, and they need the cash, and that is a fundamental problem.

We also have a plan similar to what Dr. Rivlin described as a premium support model. We think that is ultimately the way to go, and it is really a very incremental approach to Medicare reform. It basically says a lot of the things that are currently done in Medicare are simply done incompletely, and we need to make them more of a complete model based on premium support.

Senator WHITEHOUSE. Thank you, Chairman. My time has expired.

Chairman CONRAD. Thank you, Senator.

I am going to take my time now, and then we will go to Senator Begich next.

Let me just say, earlier we had a couple of references to the economist Mark Zandi, who testified before this Committee at our last hearing, and I just want to say, first of all, I think it is important to know his background. He was adviser to the McCain campaign in the last election, and I think he made clear at the last hearing his forecast was off, as were many economists', because we have had a series of events which he described in some detail last week, which I think in fairness we ought to remind people of:

First of all, the disturbances in the Middle East that had a dramatic effect on oil prices. Oil prices went up. That meant gasoline prices went up. All heating fuels went up. That operated like putting a tax on the American economy and the global economy. So that had an effect on slowing things down.

Second, we had the tsunami and the resulting nuclear disaster in Japan. That had an effect on global demand. That had an effect on manufacturing.

Then on top of that, we had the European debt crisis. We read about that every day. Greece, Ireland, Spain, Portugal, increasingly Italy, that has had an impact on confidence. And without confidence, as I think all of you have said at various times in your testimony, businesses that are sitting on $1 trillion in cash are reluctant to invest.

A final point I would make is: What kind of downturn are we having here? In part, I believe it is a balance sheet recession—that is, because financial firms had to rebuild their balance sheets, they have had to pull back from extending credit. I hear about this almost every day I am home from small businesses in terms of securing credit. And that is what the Reinharts found in their study.

And I would say to you, Dr. Foster, you say 2 years is enough for a recovery, that is not what they found. They looked at 200 years of economic history, 44 countries. What they found is it takes 8 to 10 years to recover, not 2 years—8 to 10 years. And we are 2 years into this. So we are in a very different situation than a garden variety recession.

When you have what is in part a balance sheet recession, you have weak aggregate demand. Where you have got weak aggregate demand, where is it going to come from? If the Federal Government does not put in its oar, there is no other place big enough to give lift. That is my own belief.

I also believe that whatever is done to give lift has got to be in the context of a plan that is credible and serious to get our debt under control, because the Reinharts also found once you get to gross debt of more than 90 percent of GDP, your future economic prospects are reduced. So we are in a very tough situation, and it is a complicated situation.

Dr. Rivlin, let me just ask you, do you believe that it would be harmful to at this point have dramatic cuts in Federal spending?

Hon. RIVLIN. I do.

Chairman CONRAD. And why?

Hon. RIVLIN. Because it cuts into demand. You lay off people from the Federal workforce or from the State workforces that are supported in part by Federal grants. You cut back on payments going directly to people as in unemployment compensation or food stamps or the other safety net programs. Now, nobody is going to cut those first, but some of the extensions end. So people have less money to spend, and they do not spend it, and the recession gets worse.

I believe that is why the first package, the stimulus package, prevented a worse, deeper recession, although it was not perhaps perfectly designed to do that.

Chairman CONRAD. Dr. Holzer, what do you believe?

Dr. HOLZER. I agree. I think that large and immediate cuts in spending would have harmful effects. Certain kinds of spending are more stimulative than others. It is quite interesting to me that we have delayed in extending unemployment insurance. We know—and, again, unemployment insurance in a very healthy economy could convince workers not to take jobs, but in this kind of economy with 9 percent unemployment, it is very hard to make that case. And the money seems to have a very powerful stimulative effect. The same for food stamps and other things.

I find it really puzzling that some economists will say, well, even any talk of tax increases anywhere at any time has this terrible depressive effect, but cutting spending right now is perfectly fine. That flies in the face of everything I have ever learned about macroeconomics. Spending increases and cutting taxes really have relatively similar effects in most macroeconomic models. To say that one is terrible and one is fine just does not make any sense and I think flies in the face of most of the evidence we have. Immediate cuts in spending of the kinds talked about would have depressive effects on the economy.

Chairman CONRAD. Dr. Foster.

Dr. FOSTER. Yes, thank you, Senator. I think what you see here is two very different concepts of how the economy works. This is not ideology. This is not partisanship. We have different views on how an economy works. I do not believe in alchemy. I believe when you start with lead, you end up with lead, and you do not end up with gold. When Government increases its spending and increases its borrowing, the money had to come from someplace. It is not like the Fed which actually can print dollars. The Treasury does not print dollars. The Treasury borrows money, and it had to come from someplace. And when it comes from someplace, it is not there anymore. It is not there, and we do not know who would have used the funds. Maybe it would have been consumers buying cars, maybe somebody buying a house. Maybe the trade deficit would have been lower because we did not have to import as much capital from abroad. We will never know where the money came from, but we know it came from somewhere.

So we cannot just wave a wand and create purchasing power by running budget deficits. It is not a question, as I said, of ideology or partisanship. It is a very different conception of how an economy works.

Chairman CONRAD. I think that is fair. And it is healthy for us to discuss these differences. It is amazing if some of my colleagues want to suppress these debates. I do not think they should be suppressed. I think it is critically important we have these debates and have these discussions. I think it is entirely healthy.

Senator Sessions.

Senator SESSIONS. I do, too, and thank you for allowing us to do so. We had some good hearings on policy early last year, and I think these are helpful today.

I was supposed to have floor time. I got there and Senator Alexander was talking, and he had decided not to participate in leadership but be an active Senator, and he did raise the question about fierce debate and noted the canings in history and the fights in history and duels in the Senate. So he said we need together to work accomplish common goals, but good debate is healthy.

Dr. Foster, I remember before the first stimulus package passed reading from Nobel Prize Laureate Gary Becker, who had written an op-ed in the Wall Street Journal saying this was not going to work. He predicted it would not work. You predicted it would not work.

You sort of touched on it, but essentially when you borrow money to spend money, that money comes from somewhere, and I believe you have just summed up the problem. That has a negative impact also.

Now, our Chairman mentioned the Rogoff-Reinhart study that said gross debt reaches 90 percent of GDP; then you have consequences. Actually, I have used the figure 1 percent growth is lost. I think their study actually said 1- to 2-percent growth would be lost.

Perhaps it is coincidence, but we hit 90 percent of GDP in the early part of this year, January, and immediately we are not having the growth that people projected. OMB and CBO projected growth this year to be 3.1 percent, and it is not going to be close to that. It is going to be about a point or two below that.

Dr. Zandi, I teased him a little bit yesterday. He predicted 3.9 percent. Now Moody Analytics, his firm, is predicting for the year 1.6 percent. I have my doubts we are going to reach that. So 1.6 percent is about 2 percent below what he predicted.

Do you think it is possible, I will ask all three of you, that the unexpected fall in growth projections from blue chip economists and the Government and Dr. Zandi, do you think that could be because we have already reached this debt limit that empirical studies indicated would cause a decline in growth? Dr. Rivlin, do you want to start, if you have an opinion?

Hon. RIVLIN. I do have an opinion. I think it is an interesting but totally irrelevant coincidence, and the reason I think that is the Rogoff-Reinhart study—which is a fascinating piece of work, as you know, but it looks at averages over all kinds of different countries over several hundred years, and it certainly does not indicate that all countries are the same. And the United States—unfortunately, in my opinion—has a very strong ability to borrow money cheaply. We have abused that fortunate fact by borrowing too much money cheaply for a long time.

But you look at a country like Greece right now, or even Italy or Spain, they are in trouble because they cannot borrow more money except at very high interest rates, and that is killing them.

That is not happening to us. I do not see any mechanism that is causing us at some particular size of debt to face a market reaction. That does not mean we should go on increasing the debt forever. I think that is very deleterious. But this coincidence I think is just that.

Senator SESSIONS. Well, thank you. So you see it as different maybe this time.

Hon. RIVLIN. Well, it is different for the United States because the world thinks that we are the safest place to put their money, and I hope we never disabuse them of that.

Senator SESSIONS. I think you are correct. That is an advantage we have.

Dr. Holzer, do you have any connection between the unexpectedly low growth and the study?

Dr. HOLZER. No, I do not think hitting the 90-percent figure—and I do not think my reading——

Senator SESSIONS. It is 100 percent now. It is 100 percent of gross——

Dr. HOLZER. I understand. But having read that book—and it is a fine study—I do not think Reinhart and Rogoff intended for us to believe that there is a magic line, a cliff, and that as soon as we cross that line we are in free fall. This is a rough estimate of the point at which these difficulties start to grow on average over many, many economies and many periods of time. Nothing in their analysis suggests that you cross this line and terrible things start to happen.

We all agree that we have a major long-term debt problem, and there is no dispute about that on this panel. But I would not—and I see no evidence that the capital markets are reacting in ways right now that are leading—that because you crossed that line, that is leading to slower growth. I think what has happened and other parts of Reinhart and Rogoff simply say that when the finan-

cial bubble bursts, you have de-leveraging. In most sectors of the economy, that de-leveraging limits demand. They predicted a very, very slow recovery from this. I think what we are seeing is in line with exactly what they predicted, not to mention all these other deleterious effects in the last year. I think the events of Europe have contributed very importantly, and I think, of course, a lot of the turmoil here in Washington, D.C., I think has contributed to a lot of the uncertainty and the unwillingness of employers to step forward and do more hiring as well.

Senator SESSIONS. Dr. Foster.

Dr. FOSTER. Yes, sir. There are certainly head winds in the economy: the rise in the oil prices, the tsunami and so forth. No forecaster worth his salt puts out a forecast assuming no head winds. Head winds happen all the time. A strong economy overcomes them. One of those head winds could be the 90 percent, but not in a manner that the study suggested. As Dr. Rivlin pointed out, the study suggested that you cross this threshold, which is approximate, and you are going to get interest rate effects, and we are not seeing that to date. That is not the mechanism on which there is an effect. But there is an effect, and that effect is on bad uncertainty.

The American people are worried. Now, we may think they should be worried. We may think they should not be worried. They are worried, and that worry is bad uncertainty. It is a bad uncertainty that is draining the confidence, draining the vitality out of our economy. So it does matter, but not for the reasons that the Rogoff study suggests.

Senator SESSIONS. Well, you raise the point. Let us take the first stimulus. The money has been spent. Correct?

Dr. FOSTER. Pretty much all of it.

Senator SESSIONS. And whatever stimulus we got is gone now. What are permanent costs of that $825 billion expenditure right now?

Dr. FOSTER. Well, you are going to—there is the carrying cost, the service cost from the interest, so that is certainly quantifiable. And then there is the relatively unquantifiable, which is the impediment that this bad uncertainty creates in making the decisions that would result in a stronger economy.

Senator SESSIONS. Thank you.

Chairman CONRAD. Thank you, Senator.

Senator Begich.

Senator BEGICH. Mr. Chairman, thank you very much. I actually want to follow the Ranking Member's line there, and then I have a couple other questions around housing and overall.

You know, what are the permanent results? Let me describe—I mean, because if this was a municipal government, the stimulus, the $300 billion or so, a little shy of that $300 billion was in for capital improvements, you would debt finance them like any other local government, like I did as mayor. We would build a road. The money would be spent. That is correct. You are absolutely right. But here is the result. Now there is a road. Economic development occurs around that.

I will give you an example on the stimulus money. I am glad we are getting into more robust debate because I agree with the Rank-

ing Member. The money is gone, it is spent. But here is the result. I can tell you from Alaska. I cannot tell you from Alabama or other States, but I can tell you from Alaska. We built a hospital. It is going to be completed in Nome, Alaska. It is going to employ 170 additional people, provide quality health care, making it a more livable community in the area of Alaska which will have growth.

It built some roads, which will mean new economic development around those roads, which is a private sector investment, which means more tax revenue, which means more money being generated, which means more bills being paid, more taxes being paid, and so forth and so on.

Ketchikan, we are invested into helping a shipyard which now just landed a $150 million construction of a new ship. Or in Ketchikan, senior housing that will provide housing which is paid for by the individuals who live there, which generates a revenue stream.

The way the Federal Government does the budget is the goofiest thing I have ever seen, and I am hopeful, as the Chairman and the Ranking Member have talked about reforming it, we should have two types: a capital budget and an operating budget. Because you do borrow for capital. The private sector does it, the public sector does it. The Federal Government, it is just a convoluted mess. You should not borrow for operational, but nothing wrong with borrowing for capital investment, and Recovery money was predominantly that.

Then there was about $300 billion which was tax money we took from people, but we gave it back—so it is their money—through a payroll deduction. We gave it back to them.

So, Mr. Foster, I am trying to—so there is no permanent value for investing in those kinds of infrastructure investments when you use Recovery money? I mean, we would call that a capital budget. Help me understand what—I do not get that.

Dr. FOSTER. Senator, in my written testimony, which I did not put in my 8 minutes of reading, I pointed out that I was not commenting on what the appropriate level of infrastructure spending is. From what you say it sounds like Alaska may have had the only shovel-ready projects in America, and I would be glad——

Senator BEGICH. Well, let me pause you there, let me pause you, because people when they say "only" and "no jobs created," that is an opinion. It is not based on fact.

Dr. FOSTER. No, sir, I would say it is based on a simple statement of logic. You spent the money. You created the infrastructure. Jobs were created while they were building the infrastructure. No doubt about it. You can take a camera crew to any of those locations you described and show people working. You can definitely show that those jobs were there. What you know is you had to borrow the money. Now, when you borrowed the money, that money was not available to be used elsewhere by somebody for some thing.

Now, I may not be able to take a camera crew to show you the jobs that were destroyed in the process——

Senator BEGICH. But let me ask——

Dr. FOSTER [continuing]. But I know they were there.

Senator BEGICH. But let me ask you: If you borrowed that money, in theory—I am not an economist. No disrespect to econo-

mists. I am a person who has been in the business world since the age of 14, so I deal with reality. So if you have so much money available and you are saying so much is taken out by that kind of borrowing, in effect then what would happen is rates would go up to start controlling the expenditure because obviously if I am—I will give you an example of a small business person. If I have a product and it is selling off my shelves like crazy, I am going to increase the price to the customer until I hit a certain point. But actually interest rates went the other way. They flattened. So it did not do what you said. What it did do was certain banks do not loan money; they hold it because they can do other things with it that they are not getting out to the economy. So your argument really does not hold up because interest rates actually flattened and are at the lowest levels in decades, because if the money was less, the interest rates would go up. Am I confused there?

Dr. FOSTER. Senator, the argument does hold up. The problem is one of the things about interest rates is there are a great many influences on interest rates. And right now the dominant influence on our interest rates—and I do not mean just today but 2010, 2009—in fact, going back into the 2000s were other forces at play. For example, China's large build-up of foreign exchange reserves is putting downward pressure on interest rates. That has been a factor for a long time. Right now we have the euro crisis——

Senator BEGICH. Right, but let me——

Dr. FOSTER [continuing]. Where people have noted that money is flooding into this country driving down our interest rates. So the interest rate effect is not a sign of what I said not being true.

Senator BEGICH. Right, but cheap money for business is good money if they are expanding. So that has not been a problem. It has been a problem of the people who control the faucets opening the dial a little bit. I am telling you from reality, not from a study and research and all that. I am talking about a person who has actually had to go through this, who still goes through this. My wife runs retail stores and has to raise capital for a very high risk enterprise in a retail business in an economy that is fragile. So I do not buy your argument. All I wanted to do is make sure I understood what you were saying.

Let me move on to housing, because this to me is a big issue. There is a piece of legislation pending that is a bipartisan piece of legislation. I do not understand why we do not do this, and that is, a couple of us advocate—as a matter of fact, my colleague here—who is not here right now, but Senator Merkley and I advocated this 2 years ago. And now you have 2 years of a bad economy. It has improved, but it is still rough out there. But you have some people who have been paying on these loans, their mortgages, for 2 solid years, not missing a payment. They have negative equity. Banks have no incentive to refinance them—not one incentive. Because why? They are paying. Why would they change them out and give them a lower rate? Unless they are big customer and they just want to keep their business. But if you are an average working class, it is tough.

So why not just say to these folks: Here is what we are going to do. For you that have been paying for the last 2 years—I am using this as a hypothetical, but I think this is fair. You have survived

the last 2 years. You have been paying your payments. You have negative equity. You have 7 percent or above, or whatever the loan rate might be. We want to give you an ability to refinance at the market rate, which is about 4.125, 4.25. And the Federal Reserve will buy those papers from the banks, so there is no worry about the market trying to figure out if they are going to buy them or to. Just we will do it, because if they default, they will come back to us anyway.

Let me start from here and then go down. Your comments on that? Plus it will put an enormous amount of money into the economy. Go ahead.

Hon. RIVLIN. I agree with that. It would lower the monthly payments of those families. You cannot do it for everybody.

Senator BEGICH. No.

Hon. RIVLIN. But where you have evidence of having made the payments and they are underwater—but you may have to have a limit on how much they are underwater. But I think enabling them to refinance is a very good thing to do. I am not sure I would have the Federal Reserve buy the paper. You have got Fannie and Freddie still there.

Senator BEGICH. Yes, hanging on by a threat. But that is fine. Fannie Mae, Freddie Mac. They will tell us we have no control over them despite the fact the Federal Government owns 90 percent of them. But——

Hon. RIVLIN. Well, whatever, you need——

Senator BEGICH. But some mechanism.

Hon. RIVLIN [continuing]. Some institution to buy them.

Senator BEGICH. But you agree with that concept.

Hon. RIVLIN. I do.

Dr. HOLZER. It is hard for me to comment on the specific proposal because it is a little outside my area of expertise. I would say this: It is clear that housing is an enormous drag on this economy in its current form, and all efforts to date to improve it have been hugely insufficient, I think, to deal with the level of problem we have and to stabilize that market. And if we do not stabilize that market, that will be one more major drag on the economy for many years to come. So I welcome proposals along the lines of what you suggest. I think at a general level they do make sense, and it is a much needed area to make more effort than we have to date.

Senator BEGICH. Mr. Foster? Then my time is up.

Dr. FOSTER. Senator, I think that is fundamentally correct. It is perplexing that people who have been making their payments on time for an extended basis cannot refinance their mortgages. Now, what the best mechanism—I share Dr. Rivlin's concern. Maybe the Fed is not the best way to do this. There may be a simple regulatory adjustment. But why people who have proven that they are able to make the payments should not be allowed to make smaller payments is——

Senator BEGICH. So you agree with that concept.

Dr. FOSTER. Yes, sir.

Senator BEGICH. I like it. I left my questioning with three people agreeing on something that I think has potential—two with a qualifier because—I think that is a great—I better stop while I am ahead. [Laughter.]

Chairman CONRAD. That is really good when you get all three agreeing.

Senator Ayotte.

Senator AYOTTE. Thank you, Mr. Chairman. I appreciate all of you coming to testify before the Committee today.

Dr. Rivlin, I wanted to ask you about reforms to entitlement programs, specifically Medicare. As I understand it, in a November 2010 proposal in which you did some work with Congressman Paul Ryan, there was a recommendation in that proposal that we raise the Medicare eligibility age incrementally by 2 months per year to the age of 67. And I wanted to get your views. One of the concerns I have is that as we look at where the rising health care costs, where entitlement spending is going, we need to make some responsible decisions in ways that protect those programs around here to make sure that they are preserved for those that are relying on it, particularly with the recent Medicare trustees report that came out saying that essentially it goes belly up in 2024.

I wanted to get your view whether you think that we should still gradually raise the retirement age, what other thoughts you have for reforming Medicare to make it more sustainable for future generations.

Hon. RIVLIN. The work that I did with Congressman Ryan focused on seeing—we never had a completed proposal, but seeing if we could get a bipartisan proposal on premium support. And I had forgotten that he had raising the age in there. That was not part of what he and I were working on. But I do believe that a version of premium support, particularly the one that I worked out with Senator Domenici in our task force—which is actually different from what Ryan was talking about. Anyway, I think that is a very good approach to the future control of costs in Medicare.

Raising the age, possible over a long period. It does not save a lot of money because those young seniors between 65 and 67 are not terribly expensive. It is people my age that are more expensive. And most of them are not working and do not have coverage. So you might then transfer those costs to the exchanges under the Affordable Care Act as they get set up, but that is not an advantage to the Federal Government. So I am a little skeptical of raising the age, although it certainly ought to be in the mix of things considered.

Senator AYOTTE. Do you believe we fundamentally need to reform what we are doing with respect to Medicare in order to preserve it?

Hon. RIVLIN. Yes, I do. And I think there are several fundamental reforms possible, but the one that I have come out in favor of and which is a very bipartisan idea is a version of premium support.

Senator AYOTTE. Do you think we can get there to preserve Medicare just through provider cuts?

Hon. RIVLIN. No.

Senator AYOTTE. Does anyone else on the panel want to comment on that?

Dr. FOSTER. Dr. Rivlin is exactly right. In fact, we are providing Medicare right out of existence where people, when they are my age start to think about where you might retire to, you have to

start thinking about whether or not if you move your doctor is going to see you. Doctor availability is a serious issue in this country because we keep pushing these provider cuts. We are killing a program we need with provider cuts. We have to start shifting the structure of the program to make it affordable in the manner I think essentially what Dr. Rivlin was describing.

Senator AYOTTE. I appreciate your answers on that.

I wanted to also ask about the concept of tax reform.

Dr. Rivlin, you participated in the President's Fiscal Commission, as did my predecessor, Senator Gregg, whom I have great respect for.

Hon. RIVLIN. Me, too.

Senator AYOTTE. The Fiscal Commission recommended, as did, I believe, the Chairman of this Committee, in its proposal tax reform that would simplify the Tax Code and lower rates in terms of how we would reform the Tax Code. Do you still believe that that is the best way to go forward on tax reform?

Hon. RIVLIN. I do. I think that we have an enormous opportunity because there is bipartisan support for this idea—and there has been for a long time—to reform the Tax Code quite drastically to get rid of almost all of the special provisions or transform them in a way that is more pro-growth and that we can lower the rates and raise more money. And I believe we do need more money, and that a tax reform is a path to doing that.

Senator AYOTTE. Do you believe tax reform should be—I would also obviously like the other panelists to comment on this, but if we do tax reform in that manner, that we can actually help in terms of when we look at our economy competitiveness, in terms of using our Tax Code as a way to help our economy?

Hon. RIVLIN. Well, I believe that simplifying the Tax Code and lowering the rates and getting rid of a lot of the special provisions that cause distortions in the economy is a good thing, yes.

Dr. HOLZER. I agree that broad-based—that kind of comprehensive tax reform of lowering rates and closing loopholes is a good thing and should be a big part of this discussion. But, again, I would add two important caveats to that. Number one, like Alice Rivlin, I think it is important to use this as a mechanism to raise revenue. Given the crisis in debt that we all agree on, to have a revenue-neutral tax reform effort to me makes no sense at all. It is an opportunity for raising more revenue, and we need to take advantage of that opportunity.

And, secondly, I think it is possible to make the tax system even more progressive than it is right now by employing those mechanisms. Enormous—tens of billions of dollars currently go into tax expenditures to ver high income Americans that provide no positive benefit to the economy and exacerbate the very income inequality—we have incredible levels of income inequality that this country has not seen since the gilded age that is unmatched anywhere in the industrial world. A lot of it has grown within the last few decades in a way that is not reflective of any productive activity in the economy. This kind of tax reform I think would be yet another possible mechanism of addressing that. So I favor that kind of broad-based comprehensive tax reform, but subject to those two provi-

sions that have been used to raise revenue and improve progressivity at the same time.

Dr. FOSTER. Be very clear. When you use the concept of tax reform and you are suggesting it be used as a way of raising revenue except from the economic growth you gain thereby, it is a fraud. Tax reform means revenue-neutral tax reform. We can have two debates. Let us have a better tax system. Let us have more revenue. Two debates, keep them separate, or you will do neither.

Now, I do not mind having the tax increase part, but I would like to have the tax reform part, because as Dr. Rivlin suggested, that is something that would be very important for the economy. But it is not even in the context of tax reform just about lower rates. You also have to correct the tax base. It is not just the rate but what you tax.

So when we talk about getting rid of all of the tax expenditures and broadening the base, you are heading down the wrong road. You are going to create a benefit from lower rates and exacerbate new problems by just eliminating everything that you have defined 50 years ago as a tax expenditure. The concept should be a neutral tax base, so you eliminate the distortion because you properly define them and then a lower rate.

Thank you.

Senator AYOTTE. Thank you, Doctor.

Chairman CONRAD. Thank you, Senator.

Senator Nelson.

Senator NELSON. Dr. Foster, you can start with the concept of a neutral base tax reform, but then if you get additional revenue other than growth—and I want to ask you all about the growth and the scoring of it—you could do a tax reform that you get new revenue, and it could be used to a very salutary purpose, which is deficit reduction. It does not mean it has to go to spending. It can go to deficit reduction.

So let me ask you all, one of the problems on the question of is revenue neutral, do we have a problem on scoring with CBO as to whether or not it is going to be revenue neutral? In other words, each of the three of you talked about what Senator Ayotte asked, that simplifying the Tax Code, lowering the rates because you have gotten rid of a lot of preferences, will cause economic growth. Economic growth is going to produce new tax revenue. Do we have a way of scoring that new tax revenue as a result of growth?

Hon. RIVLIN. I think you have to be careful about big claims about how fast the economy would grow if you lower the rates. I believe that it would, and I believe that the simplification would help. But once you get into making claims that this particular thing is going to grow the economy like gangbusters, then somebody else, like my colleague Mr. Holzer, might say, but if you improve the skills of the American public dramatically, of workers, isn't that going to contribute to growth? So I think you have to be a little conservative about these claims.

I do believe that we would get additional growth, but I also believe we need additional revenue because we cannot absorb this tsunami of retirees and the higher health care costs, even if we are successful in reducing the rate of growth, without some more revenue, or we will close down the whole rest of the Government.

Dr. HOLZER. Just one footnote. I agree with all that, but the Federal Government revenues, Federal revenues as a percentage of GDP I believe are at their lowest levels since about 1950. We keep hearing this political rhetoric about awful taxes, and there is no question, there are ways of structuring a tax system that would be probably more beneficial to economic growth, and I think if all three of us were designing its axis, then we would probably move somewhat more in that direction, although I still believe in tax progressivity. But in a world where the Federal Government is now taking in less than 15 percent of GDP in tax revenue relative to the burdens of spending that we are committed to as the baby boomers retire, to me it makes no sense not to talk about revenue enhancement, and it is impossible to think about really seriously dealing with this deficit without being serious about revenue enhancement.

Dr. FOSTER. Well, of course, we are at about 14.5 or 15 percent of GDP because of the recession, and then Congress continues to pass additional tax relief, like the payroll tax relief. If you look at the CBO projections further out, you end up much close to the traditional 18, 18.5 percent of GDP as a revenue. So the current measure of revenues is no indicator of whether we need additional revenues, whatever one thinks about additional revenues.

And, Senator, to answer your question directly, we do not really have the capacity credibly right now in the Federal Government, either at the Joint Tax Committee or the Congressional Budget Office, to do a credible dynamic analysis. They are working on that, have been doing so for a great many years, with little progress. But we do not really have that.

Dr. Rivlin is exactly right. We have got to be careful with these claims about what the different tax reform proposals would do for the economy. I think we would all agree that sensible reform would produce a stronger economy that would generate additional revenues that could be used for deficit reduction. But we do not currently have that ability. We are developing that ability very rapidly at the Heritage Foundation in our Center for Data Analysis. But even there this is an art form we are learning how to develop, how to work. It is not some software that you can go down to Kmart and pull off the shelf.

Senator NELSON. Well, we are engaged in a political moment in time that we have the opportunity for tax reform.

And if we do not grab it, then we have lost years in the opportunity to do something significant. What I am trying to understand from you experts is what is the consequence, the beneficial consequence of simplifying the Tax Code and getting rid of a lot of those preferences.

Now, as a practical matter, you are not going to get rid of all the preferences because too many of them are ingrained in what is considered fair and reasonable, such as mortgage interest, such as charitable deductions. But maybe there is a limit to that, and there are a bunch of other tax preferences that we have seen that have grown up over the years because people have had the ability to get to the decisionmakers to get their particular tax itch scratched.

And I want to see us take this opportunity, and this super committee is the opportunity.

I want to just ask one technical question, Dr. Rivlin. You said that your task force with Senator Pete Domenici had come up for some version of premium support. Can you define that for us with regard to Medicare?

Hon. RIVLIN. Yes. The version that we support would say the following: Seniors after a certain date would get a choice whether they stay in ordinary fee-for-service Medicare or whether they go to a new exchange on which they could choose a plan, and there would be competition among health plans, and the health plan would be compensated by Medicare in a risk-adjusted way. This is not a voucher where you go out and shop around, but the health plan would be compensated.

But—and this is where the scoring comes in—the original amount of the subsidy for Medicare would be the same whether you stay in fee-for-service or go to the exchange, but it would increase only at a defined rate. The rate we chose was GDP plus 1 percent. Now, that is a little lower than the current increase. One would hope that the competition on the exchange brought the cost down within that. If it did not, then whether you were in the exchange or in the fee-for-service system, you would have to pay an additional premium. It could be a means-tested premium, but it would be a premium. And if the Congress decided that was shifting too much cost to the beneficiaries—and you might worry about that—then you could change the formula. But that is how it would work.

Senator NELSON. Mr. Chairman, do you remember when we were doing the health care bill how critics were saying that the world was going to come to an end when we were taking on Medicare HMOs, Medicare Advantage? Did you hear CMS' announcement last week that nationally the premiums for Medicare Advantage as a result of the reforms that we did in the health care bill have gone down 4 percent?

Chairman CONRAD. Yes, I did see that.

Senator NELSON. And the enrollment has gone up 10 percent.

Now, let me just a little coda. You know what it is in Florida? The premiums have gone down 26 percent and the enrollment has gone up 20 percent in the State with the largest number of enrollees in Medicare Advantage.

Chairman CONRAD. And the predictions were that it was going to be just the opposite, that we were going to kill the program. Instead, the program has thrived. So much for all the expertise within the Beltway.

Senator Sessions, any last-minute observation?

Senator SESSIONS. Well, thank you, Mr. Chairman.

Senator Begich made a reference to the stimulus bill and the roads that are built. I was very disappointed how little infrastructure was in the bill. Roads and bridges specifically were 3 percent. And I do agree that while we can dispute whether you get a real growth from a stimulus road-building program, you cannot dispute that when it is over, you actually have a road and bridge that you can use, and that is beneficial; whereas, most of the money that we spend in this program were one-time expenditures that did not.

I also would note that CBO scored that stimulus package over 10 years as having a net negative to the economy. They scored it as

being positive before it passed, as being positive in the short run and negative over 10 years. I am afraid we have had what positive we have had, and I think now we are beginning to draw on the negative.

In response to a question from me last week, Dr. Zandi responded, "I do not think $2.4 trillion is enough," talking about the cuts that the Committee of 12 is charged with achieving. He goes on to say, "I think we need—if you do the arithmetic, I think there is a general consensus we need $4 trillion in a 10-year deficit reduction. That $2.4 trillion is not enough, no."

Would you agree? I will ask you three if you could be brief. Would you agree with that?

Hon. RIVLIN. I would definitely agree with that. I think that the consensus in Simpson-Bowles and in the Domenici-Rivlin group and others that have looked at this problem, if you are going to stabilize the debt, you need $4 to $5 trillion in savings over the next 10 years, and it is going to be more——

Senator SESSIONS. That is what you call for in your Commission that you and Senator Domenici chaired.

Hon. RIVLIN. Yes. Now, it gets into some baseline problems, but that is the basic story.

Senator SESSIONS. Dr. Holzer.

Dr. HOLZER. I tend to agree that 2.4 is probably too little and that it needs to be in that $3 to $4 trillion range. And, of course, there are many ways of measuring, many different baselines that can be used, and we want to have more honest baselines. We have a caveat I would add, though. Once again, deficit reduction in the short term could be harmful to growth, depending on how it is done, and could further reduce revenues coming in and require more automatic expenditures. So it is important to balance the overall number with a backloading of a lot of the provisions.

We are going to be facing slow economic growth perhaps for much of the rest of the decade, so even—we have to trade off and balance off the serious debt reduction we need, but doing it in a way and in a manner with timing that does not put an undue burden on the economy over the next handful of years.

Senator SESSIONS. Dr. Foster, I would ask you to respond to that question, and then with regard to the idea of another stimulus, you spend $400 billion or so. That digs the debt hole deeper, and we have got to raise that money before we even get back to the level that we are now at in terms of the projected debt situation. Would you comment?

Dr. FOSTER. Yes, sir. Basically it is a simple enough matter. You have to stabilize your debt as a share of GDP at some point and then from that point forward. So in a sense, as the President suggested, it is a matter of math.

Of course, this is not the math exactly he was referring to.

And you do not have to get there all at once. The Congress just passed one bill with $900 billion or so of progress.

You can do it in a series of steps, but they do need to be short-term steps; that is, one following quickly upon the other.

Senator SESSIONS. You think that the $2.4 trillion is not enough?

Dr. FOSTER. I think eventually you are going to need something closer to $4 or $5 trillion, especially if we are sliding into a reces-

sion again or into a period of very, very slow growth. We are then not going to be getting the revenues that were expected, the deficit is going to be that much larger, and the hole we have to dig out of is that much deeper.

Chairman CONRAD. Thank you, Senator.

Let me just say, I was part of the Fiscal Commission.

Senator Gregg and I had pushed that starting 5 years ago because we saw that we were headed for a debt threat overhanging this economy that had to be faced up to.

We agreed that everything had to be on the table. We agreed that we need fundamental entitlement reform. To my colleagues on the left who resist that, I would just say I do not know any way around it. The harsh reality is if you look at the demographics, if you look at our budget, we are going to have to deal with the entitlement side of the ledger. That is the biggest part of the Federal budget. It did not used to be. It used to be about a third of Federal spending. Now it is 60 percent, and growing. And the demographics are as clear as they can be.

So to those friends of mine on the left who say, no, no, you cannot, you got it all wrong, we do not have to touch that, really? The trustees say we are headed for insolvency.

And to my friends on the right who say you do not have to touch revenue, really? Revenue is the lowest it has been in 60 years as a share of national income. That is where it is. It is the lowest it has been. Spending is the highest it has been. To me it is very clear you have got to work on both sides of this equation.

And to those who say that is a job killer, that is not what the evidence shows. It just is not.

Let me just put this up. This is a look at different top marginal rates and what economic growth has been. At the end here is a top marginal rate, 28 to 31 percent.

Economic growth during those periods, average employment growth has averaged 1.1 percent. Where we are now, top rate of 35 percent, virtually no employment growth; 38.6, which is what we had, the previous top rate was half of 1 percent.

When we had a top marginal rate of 39.6 percent, employment growth averaged 2.4 percent. When we had a top marginal rate of 50 percent, employment growth averaged 2.1 percent, and on up from there.

So, you know, this idea that the top marginal rate is a jobs killer, there is no evidence in the real world, in the real economy, that that is true. There is no evidence that that is true.

So I do not know. We are in a very stale debate around here between the two parties, to me. Very stale. And it is not going to solve the problem to be stuck with a stale, tired, phony debate. At some point we have got to get real, and getting real means both sides need to get off their fixed position. And the faster it happens, the better.

I thank the witnesses for participating today, and we will stand in adjournment.

[Whereupon, at 11:30 a.m., the Committee was adjourned.]

Kelly A. Ayotte

Questions for the Record
from Senator Ayotte
for Dr. Alice Rivlin
Promoting Job Creation in the U.S.
September 20, 2011
Senate Budget Committee

Question #1:
One of the Fiscal Commission's recommendations was to create a new Cut-and-Invest Committee to identify 2 percent of the discretionary budget that should be cut and identify how to redirect half of that savings, or 1 percent, into high-value investment.

The Commission stated (and I quote): "The significant growth in domestic spending over the last decade has brought an alarming proliferation of federal programs – many of which duplicate pre-existing federal efforts and each other. Instead of eliminating outdated or ineffective initiatives, Congress often simply creates more programs to address the same concerns. The result is a patchwork of thousands of duplicative programs, nearly impossible to track and even harder to evaluate for effective outcomes. Duplication results in unnecessary deficit spending and crowds out important investments."

To support this recommendation, the Commission pointed to a duplication of federal job training programs that are spread over several agencies.

In January, the GAO issued a report entitled "Multiple Employment and Training Programs". One of the key findings of this report was that in FY2009, nine federal agencies spent approximately $18 billion to administer 47 separate and duplicative employment and job training programs. The report also found that almost all federal employment and training programs overlap with at least one other program in that they provide similar services to similar populations.

1. I think we can all agree that a significant amount of government waste exists, yet the redundancy of these job training programs appears to be especially ripe for reform. I don't doubt that federal job training programs have some merit; however, in your opinion, would efforts to consolidate these 47 programs result in promoting job creation? How?

Dear Sen. Ayotte:

You asked if consolidation of the government's multiple job training programs would create jobs. I am not an expert on the details of these programs, although I am familiar with some of them. I think job training programs are a good example of the proliferation of relatively small programs that has taken place over the years. The objectives are not all identical, but consolidating many of these programs could save administrative costs. Ideally, the consolidation should be accompanied by a serious effort to evaluate the effectiveness of various job-training approaches and use the money more effectively. This would require time and resources, but, if it were done well done, could result in more people getting trained in ways that helped them obtain jobs (or better jobs). I would not expect major job gains from the consolidation alone, but more effective training could certainly reduce some unemployment and raise the trainees' future incomes. For a more precise answer you might turn to some of the experts who have evaluated federal and state training programs.

Sincerely,

Alice M. Rivlin

IMPROVING THE BUDGET PROCESS: STRATEGIES FOR MORE EFFECTIVE CONGRESSIONAL BUDGETING

TUESDAY, OCTOBER 4, 2011

COMMITTEE ON THE BUDGET,
U.S. SENATE,
Washington, DC.

The Committee met, pursuant to notice, at 9:30 a.m., in Room SD–608, Dirksen Senate Office Building, Hon. Kent Conrad, Chairman of the Committee, presiding.

Present: Senators Conrad, Wyden, Nelson, Cardin, Whitehouse, Begich, Coons, Sessions, Enzi, Thune, Johnson, and Ayotte.

Staff Present: Mary Ann Naylor, Majority Staff Director; and Marcus Peacock, Minority Staff Director.

OPENING STATEMENT OF CHAIRMAN CONRAD

Chairman CONRAD. The hearing will come to order.

I want to welcome everyone to the Budget Committee today. Today's hearing is titled "Improving the Budget Process: Strategies for More Effective Congressional Budgeting." We are going to specifically consider biennial budgeting and proposals to reform the "vote-a-rama" process.

We have two outstanding panels of witnesses today. Our first panel, which will focus primarily on biennial budgeting, includes:

Maya MacGuineas, president of the Committee for a Responsible Federal Budget. Welcome, Maya. Always good to have you before the Committee.

David Kendall, senior fellow for health and fiscal policy at Third Way. Good to have you here, Mr. Kendall.

And Donald Kettl, dean of the University of Maryland School of Public Policy. Thank you so much for participating as well.

Our second panel, which will focus primarily on the vote-a-rama process, includes: Bill Hoagland, the former Republican Staff Director of the Senate Budget Committee; Marty Paone, the former Democratic Secretary of the Senate; and Eric Ueland, the former Chief of Staff to Senate Majority Leader Bill Frist. Another distinguished panel, and we appreciate very much the willingness of all of you to participate.

We are holding this hearing because I believe the current budget process is broken. It has become increasingly difficult to pass budget resolutions in election years, and year after year we face continuing resolutions, omnibus bills, supplementals, and, increasingly, threats of shutting down the Government. At the same time,

we have far too little oversight of Federal agencies and programs. If there is a place where the Ranking Member and I are in complete agreement, it is that this budget process needs to be reformed and that this Committee needs to play a lead role in oversight. And when you are doing a budget every year, you really do not have the time to do the oversight that is desperately needed.

Biennial budgeting will not solve all of our problems, but it could help. I now believe the positive attributes of moving to a biennial budget, including more oversight in the non-budget years, certainly outweigh the possible negative considerations.

This is how biennial budgeting would work. Would you put up the slide? In odd-numbered years, the President would submit a 2-year budget, and Congress would pass a 2-year budget resolution and enact 2-year appropriations bills. In even-numbered years, Congress would focus on authorizations and oversight.

Now, here are some of the arguments for biennial budgeting.

One, Congress has effectively moved to biennial budgeting already. In fact, since 1998 budgets have been passed in only 2 election years: 2000, when Senator Domenici was the Chairman of this Committee, and 2008, when I was Chairman.

Second, biennial budgeting would allow Congress to spend more time on oversight. This would result in more accountability from the executive branch, ensuring that scarce Federal resources are being used efficiently and effectively. It would also reduce the use of continuing resolutions and omnibus bills, and it would allow for better long-term planning by Federal agencies and programs. Could you imagine running one of these agencies and you are on a continuing resolution for 3 months, for 4 months, for 6 months? This is no way to run an enterprise of any size.

There are those who argue against biennial budgeting, and we ought to very directly acknowledge their criticisms. They believe: one, it would reduce the ability to respond to changing economic and geopolitical conditions; two, it could result in more supplemental funding, especially in the second year; and, three, oversight through the appropriations process could be diminished.

You know, I used to be in the camp of favoring an annual budget. I did so on the basis that I do not know of any institution of any size that does not do an annual budget. But the hard reality is we are not doing annual budgets. We just are not. We have only done two in the last 13 years.

So, look, let us face up to the reality. In these even-numbered years, election years, let us focus on oversight during that period and have done the budget the year prior for 2 years.

Also, I want to ask for unanimous consent at this point to enter into the record a letter from Senators Shaheen and Isakson, a Democrat and a Republican, to the Joint Select Committee on Deficit Reduction expressing their support for moving to a biennial budget. They have done a lot of work on this. It is good work. I certainly want to commend them publicly for the efforts that they have made.

[The information follows:]

United States Senate
WASHINGTON, DC 20510

October 4, 2011

Senate Budget Committee
Improving the Budget Process: Strategies for More Effective Congressional Budgeting
Joint Statement by Senator Johnny Isakson and Senator Jeanne Shaheen
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Today's hearing represents an important step toward improving the reliability, efficiency and transparency with which Congress produces the federal budget. We commend Chairman Conrad and Ranking Member Sessions on holding this hearing and are grateful for their continued focus on fixing our broken budget process. We are further grateful to the witnesses who join the Committee today to share their unique federal budgetary insights and expertise.

Solving our long-term deficit problems will require tough choices in every area of the federal budget, but we will never be able to make those choices unless we change the way we do business in Washington, D.C. That is why we have joined in proposing fundamental, common-sense reform to bring needed oversight and scrutiny to the federal budget process.

Our legislation would convert the federal budget process into a two-year, more thoughtful process, allowing Congress to conduct additional oversight. The *Biennial Budgeting and Appropriations Act* dedicates the first year of a Congress to appropriating federal dollars and devotes the second year to scrutinizing federal programs to determine if they are working and deserve continued funding.

As Members of Congress, we are entrusted with the responsibility of spending taxpayer dollars wisely. Our current budget and spending process makes it all too easy for waste and inefficiency to remain hidden. Switching to a biennial budgeting process would be a big step toward fiscal responsibility at a time when all of us agree we must focus more attention on the nation's bottom line.

We recently wrote to members of the Joint Select Committee on Deficit Reduction urging them to consider this legislation while searching for ways to reduce spending. The text of this letter appears below.

Johnny Isakson

Jeanne Shaheen

Congress of the United States
Washington, DC 20510

September 26, 2011

The Honorable Jeb Hensarling
Co-Chair, Joint Select Committee on
Deficit Reduction
129 Cannon House Office Building
Washington, DC 20515

The Honorable Patty Murray
Co-Chair, Joint Select Committee on
Deficit Reduction
448 Russell Senate Office Building
Washington, DC 20510

Dear Representative Hensarling, Senator Murray, and Members of the Joint Select Committee on Deficit Reduction,

As you know, our deficits have reached an unsustainable level and we need to act to put our government back on a fiscally sustainable path. While many tough choices lie ahead of us, there is an easy choice that would make our federal agencies more efficient while simultaneously creating greater opportunity for congressional oversight: move from a one-year budget cycle to a two-year cycle. Such a change would help restore order to the broken budget process and promote the responsible use of taxpayer dollars. Biennial budgeting is a critical common-sense reform that will provide greater stability and predictability in the budget process and will improve much-needed oversight and management of federal programs.

We write to urge you to take the *Biennial Budgeting and Appropriations Act* into consideration while searching for ways to reduce spending. *The Biennial Budgeting and Appropriations Act* would help change the way we do business in Washington so that Congress can make the tough choices needed to confront our mounting deficits and better prevent future waste. The current appropriations system drains time from Congress' ability to effectively oversee our federal government. Many appropriations for nondefense programs operate under authorization laws that have expired. A two-year budget cycle would allow Congress to dedicate every other year to reviewing these authorizations. At the same time, this legislation would make federal agencies more efficient by allowing them to devote less time to the budget process and more time to doing their jobs.

Specifically, the *Biennial Budgeting and Appropriations Act* would require the President to submit a two-year budget at the beginning of the first session of a Congress. Members of Congress would then adopt a two-year budget resolution, a reconciliation bill if necessary, and two-year appropriations bills by providing a new majority point of order against consideration of an appropriations bill that fails to cover two years.

The second session of a Congress could then be devoted to the consideration of authorization bills and oversight of federal programs. We believe the enhanced oversight will result in more accountability of government programs, thereby decreasing wasteful spending.

One of the great advantages of our federal system is the opportunity to take what works in the states and apply it at the national level. Presently, 21 states operate under a two-year budget cycle. In New Hampshire we have seen the benefits of biennial budgeting firsthand.

Agencies were able to get the most out of their budgets simply by doing their jobs, rather than spending their time engaging in a protracted budget process.

Support for a two-year budget cycle extends well beyond the state level. This legislation has enjoyed bipartisan support at the federal level for several years. A biennial budget system is an idea that has been endorsed by each successive president since Ronald Reagan, as well as numerous federal budget experts.

Congress has repeatedly failed to pass spending bills on time and frequently resorted to omnibus bills at the last minute instead. The current process is so broken that since 1980, Congress has only twice completed appropriations legislation on time.

As members of Congress, we have a responsibility to spend taxpayer dollars wisely. Our current budget and spending process does not help us meet that responsibility. Instead, it creates an atmosphere in which waste is all too common. If we are serious about reducing future wasteful spending, we must consider changing this broken process to focus more on looking at what works and what does not work. Biennial budgeting is a strong step in the right direction and we hope we can count on your support.

Sincerely,

Johnny Isakson
United States Senate

Jeanne Shaheen
United States Senate

Identical letters sent to:

The Honorable Max Baucus
The Honorable John Kerry
The Honorable Jon Kyl
The Honorable Rob Portman
The Honorable Pat Toomey
The Honorable Xavier Becerra
The Honorable Dave Camp
The Honorable James Clyburn
The Honorable Fred Upton
The Honorable Chris Van Hollen

cc:
The Honorable John Boehner
The Honorable Harry Reid
The Honorable Nancy Pelosi
The Honorable Mitch McConnell

Chairman CONRAD. As I mentioned, our second panel will focus primarily on reforming the vote-a-rama process. It is important to remember why we have a vote-a-rama. Under the Congressional Budget Act, the budget resolution and reconciliation bills are given special fast-track treatment that limits debate: 50 hours for a budget resolution, 20 hours for a reconciliation bill, and both measures can be passed with only 51 votes. It is a rare use of majority rule in the Senate. It means these measures cannot be filibustered.

As a way to protect the rights of the minority, the Budget Act allows an unlimited number of amendments to be filed even after all time has expired on the resolution or reconciliation bill. So as frustrating as the vote-a-rama may be for Senators, the ability to offer unlimited amendments is meant to safeguard minority rights in the absence of the right to filibuster.

The problem is what that has developed into in reality. It has really gotten out of control. And, frankly, one impediment to getting a budget resolution done is leadership does not want to go through vote-a-rama. And they are supported by many of our colleagues who say, you know, that is a spectacle to have vote-a-rama when Senators are voting seriatim without time for debate.

In fact, typically, we, by unanimous consent, agree for 2 minutes on an amendment, 1 minute a side, on serious matters. So I have had Senators say to me they were not certain what they were voting on when they voted in vote-a rama. That is not the way the Senate should conduct its business.

Vote-a-rama results in back-to-back votes in the Senate which sometimes drag on for several days, very long hours. Senators become tired, some cranky—I will not name any names—and even confused, because you are voting so quickly with so little consideration. It allows little time to review and debate the many amendments that are offered, and the process has become in some ways a spectacle and results in few substantive changes to the budget, but I think really embarrasses the institution. This is not the way I think our Founding Fathers thought the Senate would act, dealing with very consequential measures with, at most, 2 to 5 minutes of discussion evenly divided. The fact is if you did not get consent, you would not have any time. You would just vote. No debate.

I think it is clear—it is certainly clear to this Senator—that the process needs to be reformed. I believe we can improve it while still protecting the rights of Senators. And I have been in the minority, I have been in the majority, and I know the tide changes around here, and it will change again in unpredictable ways. I think we have got to write this with the view that either one of us may be in the majority or the minority. So we have got to be very conscious of minority rights. But we have also got to be conscious of a system that is functional, not dysfunctional.

One concern with the current vote-a-rama process is it is increasingly being used on issues completely unrelated to the budget. Here are some of the amendments filed during the fiscal year 2010 budget resolution debate: prohibit legislation restricting second amendment rights; prohibit the transfer of detainees at Guantanamo Bay to the United States; require drug testing of Temporary Assistance for Needy Families; require Amtrak to allow passengers to check firearms in their baggage; prohibit climate change legislation from

regulating methane emissions from biological processes associated with livestock production.

Well, whatever the merit of those individual matters, I think we can agree the budget resolution is probably not the place to resolve those matters. The budget resolution should be to resolve budget matters.

The number of amendments offered to budget resolutions has generally been rising. In fact, according to the Congressional Research Service, 2007, 2008, and 2009 were among the top 5 years with the most amendments offered, and the percentage of votes taken on amendments offered after all time has expired has been rising. This means that Senators are increasingly taking votes on amendments that were given very little time for debate.

For example, in 2003, we had 50 votes, 80 percent of which were on amendments that were given no time for debate. You know, that does not make much sense. No time for debate.

Here are some potential ways we could reform the vote a-rama process.

We could create filing deadlines for first and second degree amendments. This would prevent amendments from being filed after all time has expired and hopefully allow more time for debate.

We could increase the number of amendments debated prior to vote-a-rama by reducing the time allotted to each amendment. Again, this would hopefully encourage more substantive debate on amendments.

We could limit the number of amendments during vote-a rama itself.

We could establish a brief layover period to review amendments.

And we could allow the yielding back of time only by unanimous consent. This will help protect a Senator's right to continue debate on amendments in light of the other changes we might make that would limit amendments being offered.

The vote-a-rama process we have now I believe demeans the Senate as an institution. While reform is likely to involve changes to the process, these changes can be carefully constructed and are a necessary tradeoff if we want to bring more order to the process and improve the Senate's ability to consider the budget resolution and reconciliation bills in a thoughtful and thorough manner. Whatever we do, we do have to protect minority rights.

The fast-track procedures of the Congressional Budget Act are unique and place limitations on debate that are uncommon in the Senate. I have been in the minority, and I appreciate that the right to offer amendments allows the minority to raise substantive issues. But, frankly, you know, we have gone beyond that. We really have. We have almost gotten to the point where vote-a-rama has become an abusive exercise for all Senators. And, interestingly enough, it is really a relative handful on both sides who tend to abuse the process. It has become well known to the Chairman and Ranking Member who the Senators are that are going to insist on amendments even when amendments virtually identical to theirs have already been considered and voted on. We have had times where we have had almost the identical amendment offered three or four times. Really. I mean, how many times do we have to vote to establish a record?

With that, we will now turn to Senator Sessions for his opening remarks, and then we will hear from our first panel of witnesses.

OPENING STATEMENT OF SENATOR SESSIONS

Senator SESSIONS. Thank you, Mr. Chairman, and I look forward to the good panel and to working with you to reform and strengthen the budget process.

One of the most important reforms we can achieve is the adoption of a biennial 2-year budget. I have long supported such legislation. I worked with Senator Domenici a number of years ago. He also supported it. But we never really confronted the issue and brought it up and had a full debate about it. So I thank you for your leadership in working in that regard.

This may be just the year to get it done. I think there is a lot of frustration and a lot of desire for improvement, and I think we could have a bipartisan agreement, and with your leadership, we maybe can get it done.

Before I begin the discussion on that particular issue today, I would like to give a little context. Many have said the congressional budget process is broken. In my view, however, it is not that the budget rules will not work but, rather, Congress has refused to follow the rules. Despite a legal statutory requirement that we do so, for 2 consecutive years the Senate has simply refused to adopt the budget resolution. It has been 884 days. We are not passing appropriations bills. We are funding the Government with stopgap measures or cramming all our spending bills into one big omnibus spending bill, and this is no way to run a budget or run an efficient Government.

Federal spending has reached nearly $4 trillion a year, and almost half of that is borrowed, over 40 percent. Yet the myth persists in Washington that we can manage this mammoth budget through last-minute deals struck in closed door meetings, rushed to a vote under a threat of panic and Government shutdown. But we cannot and we should not operate our Nation's finances in this way, especially not during this time of fiscal and economic crisis that is very real, that is systemic, and I believe in a financial sense has never been greater. There is no time in our history when we can look a decade out and can see a more difficult debt financial situation than we can see today. Our constitutional system was designed and Americans deserve an honest budget, publicly produced, with amendments offered and Senators voting.

Now, I know leaders do not like their troops to vote. They might have to cast tough votes. But part of the process in the Senate has always been that you have to have votes. So producing a budget is one of our most fundamental duties, and in these difficult times we should be rededicating ourselves to that commitment and in no way setting it aside.

Now is the time to strengthen the budget process, not abandon it. The Super Committee of 12 that has some of our finest members in it in a few months is expected to perform the duties of the entire Congress. Earlier this year, I offered a measure to make it more difficult for Congress to skirt its budget responsibilities. It would raise the threshold a bit to 60 for passing an appropriations bill before a budget has been passed. Common sense says you pass a

budget, set what your spending limits are before you start spending money.

So I believe this is a needed reform. A 2-year budget can help. The Senate should not spend the taxpayer's dollar without a plan. The budget should go through the regular order. Only a simple majority is required, and it should be subject to extensive amendment and debate. And we can talk about how we do that, but there is a growing frustration on the minority side that amendments are being blocked through the process of filling the tree to an unprecedented degree, and we are lacking the kind of debate on the normal processes of the Senate, and there will be more resistance, I think, to tightening up the budget amendment process for that reason.

But I strongly believe we can improve the existing system by switching to a 2-year budget cycle. This approach will make it easier to save money and perform oversight. Under the current system, an executive agency is having to begin work on a budget for next fiscal year before the current budget has even been adopted or approved. Additionally, by switching to a 2-year plan, it will be easier for agencies to reduce waste and I do believe plan. Our Government agencies are challenges. I think they can plan better if they have more confidence in the future of what the funding will be.

I think the greatest advantage offered by a 2-year budget cycle is enhanced oversight, as you said, Mr. Chairman. As it is, I believe the Committee does have a duty to perform careful oversight of the executive branch, but we must search through the Federal Government for waste, inefficiency, and overreach. We simply have to. But the adoption of a 2-year budget provides a chance to make this duty more explicit and to significantly increase the Committee's oversight authorities. We owe the taxpayers nothing less. In order to balance our budget, we are going to need to conduct an exhaustive search for savings. A biennial budget offers the opportunity to increase the time and resources dedicated to that task.

But the process of reform will achieve little if we do not rethink and address the underlying problem: the ideology of big Government. As long as Washington operates on the idea that the Federal Government is the first place to fix every problem that arises, then our budget will tend always to be too large, too hard to manage, and too heavy a burden on the economy. Members owe the American people more than just a strengthened budget process. They owe a strengthened commitment to the principles of limited Government and individual responsibility.

So we have got tough challenges ahead, but if we face them honestly and in keeping with our values, there is no doubt that our Nation will thrive and prosper. I think you have got a good panel, Mr. Chairman. It is exciting to think that it could be in maybe even months we could have a better budget process, and I look forward to working with you on it.

Chairman CONRAD. This is our chance. I really believe it. We have an opportunity here to do something that has not been done since the creation of the Budget Act, and working together, I think we have an opportunity to really do something that would be important—important for the country, important for the Senate, important for this Committee, important for our colleagues in the

Senate—because we have to rebuild a budget process that really works.

With that——

Senator SESSIONS. Mr. Chairman, a budget, properly considered, really is a vision for the future. It ought not to be just thrown together every year rush-rush. It ought to be given some thought, and I think through the oversight process in the off year, we maybe will be prepared better to envision a 2-year spending plan that is really more appropriate for our country.

Chairman CONRAD. And I tell you, I think one thing we could accomplish here is to make agencies more accountable. Make them more accountable. When they are provided the dollars in a budget, to have them come back in the second year and explain what are they producing, what is coming out the other end, what is actually getting out to our constituency, how much is being burned up in the bureaucracy, I think our constituents would be very interested in that, and I think we could do a real service.

We will go to Maya MacGuineas, thank you, Maya, president of the Committee for a Responsible Federal Budget. We will ask each of the witnesses to testify in turn, and then we will open it up for questions. Welcome.

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

Ms. MACGUINEAS. Great. Thank you. Thank you, Mr. Chairman and members of the Committee, for the opportunity to testify, and it is always a privilege to appear before this Committee.

I share the belief that I think many of you have, that in many ways our budget process is broken. There are many reforms that we could and should make to improve it, and yet none of these changes will replace the hard choices that need to be made to fix our dangerous fiscal situation. And in order to do that, we need to change our spending and our tax policies, and the sooner we get a plan in place to do that, the better off we will be.

The Committee for a Responsible Federal Budget and the Peterson-Pew Commission on which I served have made a number of recommendations to change the budget process. A number of these include: setting a medium-term debt target and corresponding debt and savings targets to create a glide path to get there; using broad-based budget triggers with no programmatic exemptions to ensure that the targets are met; following the enactment of a deficit reduction plan to stabilize the debt, using additional triggers and caps on both spending and tax expenditure to make sure that any plan stays on track; requiring the President to issue annual progress reports on the effects of all new legislation and progress towards longer-term fiscal goals; presenting budget allocations compared to the previous year's levels as well as other baselines; reforming the way for which emergencies are budgeted; and increasing the level of scrutiny and oversight on tax expenditures as well as other spending in the budget.

Today I have been asked to focus the bulk of my remarks on biennial budgeting, which the Committee for a Responsible Federal Budget has long supported. And I will also touch upon an extension of the idea, which is multi-year budgeting.

Under biennial budgeting, the country would shift from a 1-year budget cycle to a 2-year budget cycle, and this would free up considerable time to devote to better oversight of current programs.

Senator Conrad, I think you gave sort of the perfect overview of the advantages and disadvantages of biennial budgeting, and I think it is hard for anybody to argue against the need for better oversight. One of the greatest challenges that we have a Nation going forward, I think, given our fiscal realities, is how are we going to do more and do it better in an era of constrained fiscal resources, which is something we are going to face for a number of years, if not decades.

Improved oversight is going to be a key to meeting this challenge, and I think we all know waste, fraud, and abuse is never going to be the answer to the fiscal woes that we face, but there is absolutely no excuse for not ferreting out every single dollar of waste, fraud, and abuse that we can find in the budget, as well as improving the performance of all the programs, tax, and spending that we have.

So currently we actually collect a considerable amount of data on the performance and effectiveness of various Government programs. However, we do not do a particularly good job of integrating those findings into the budget process and using these metrics to help inform what choices we make in an era of allocating resources with constrained resources.

More time to better integrate these findings would lead to better budget choices. There is no question about that. I would also add that now with the 10-year caps that were part of the Budget Control Act, much of the work of the annual budget exercise has already been done, again, freeing up more time for this needed oversight.

So there are number of ways in a second year in a biennial budget system that you could use the time for additional further evaluation and oversight, also priority setting and deeper studies in certain budget areas, so I will delve into just a couple of those.

One possibility would be to create a budget concepts commission. Such a commission would look into a number of issues, including better accounting, particularly for long term spending programs, fiscal exposures, insurance programs, and programs that are intended to be pre-funded; improving the construction and use of budget baselines; capital budgeting and dynamic scoring issues; looking at tax expenditures, which are becoming an increasingly important part of the way we budget; accounting for private securities; leasing and public-private partnerships; and trust funds. So there is clearly a whole host of issues that we need a new budget concepts commission to look at, something we have not had in decades. And as the nature of budgeting continues to evolve, a freestanding budget concepts commission would be immensely beneficial in improving accounting, transparency, and performance.

A second possibility is to spend more time setting and ranking national priorities. Senator Sessions, you were sort of talking about the "big think" of where we are headed, analyzing the linkage between the programs and tax and spending programs that we have and how they match up with those priorities. This practice is referred to in some nations as portfolio budgeting, and in many ways

it makes the practice of budgeting more purposeful as well as transparent and focused.

Related to this would be using the off years to engage in broader strategic planning for the Nation. Currently not only is there no fiscal road map for the country; there is no broader strategic path. And efforts to identify short-, medium-, and long-term goals, threats and opportunities, and changes in the political and economic landscape would guide policymakers as they take a step back from the nuts and bolts aspects of crafting a national budget and think about a bigger framework for where we want to head as a Nation.

Finally, we might consider producing topical reports regarding the fiscal health of the country. Australia, for instance, issues its Intergenerational Report every 5 years, which assesses the implications of current policies over a longer time horizon and looks at changes in things like demographics. A deeper dive into topics such as the interconnectedness between Federal, State, and local budgets or fiscal exposures due to contingent liabilities and implicit budget commitments would be immensely useful in identifying, and hopefully avoiding, future budgetary challenges and crises.

So I think we should also consider multi-year budgeting. Right now I think we all know that the country needs a fiscal plan to get us to a sustainable debt level. Such a plan will probably need to span an entire decade, and ideally we would put such a plan in place immediately and allow many of the changes to phase in more gradually.

In order to be credible, there has to be a real commitment to staying on track for the duration of the plan, and one of the purposes of putting a plan in place, of course, is to reassure credit markets and rating agencies and provide families and businesses with much more stability—the stability that they need to plan and invest and help grow the economy. And in order to be effective, there must be the presumption that the plan will remain in effect until the objectives are actually achieved.

So my final point will be this: Regardless of the budget process improvements that we make, the single most important change we can do to change the fiscal health of our Nation is put in place a package of policy changes sufficient to stabilize the debt at a manageable level and put it on a downward trajectory relative to the economy. The Joint Select Committee on Deficit Reduction has a remarkable opportunity—remarkable opportunity—to put in place reforms that will help set the country on an improved fiscal path. The $1.5 trillion in savings they are trying to achieve would be a significant improvement, though not actually enough to stabilize the debt, and we believe the Joint Select Committee should work to focus on the largest problems in the budget—particularly entitlement spending on health care and retirement, and the Tax Code—and attempt to come up with larger savings in order to put the debt back on a sustainable path.

So budget process reforms will be helpful in encouraging these policy reforms, and they are critical in making sure that they stick. However, the heavy lift will come from making the actual decisions about what spending to cut what revenues to increase, how to ensure that these changes are conducive to economic growth, and how

to protect the many core principles and values on both sides of the political aisle that come into play as part of the Federal budget. We should not delay in making any of these changes.

Thank you once again for the opportunity to testify and to the many members of the Committee for all of your leadership on these critical issues, and I look forward to the discussion.

[The prepared statement of Ms. MacGuineas follows:]

Hearing before the Senate Budget Committee on

Improving the Budget Process:
Strategies for More Effective Congressional Budgeting

Tuesday October 4, 2011

Testimony of Maya MacGuineas
Committee for a Responsible Federal Budget at
The New America Foundation

Good morning, Mr. Chairman and Members of the Committee. Thank you for the opportunity to testify today on the important topic of improving the budget process. It is a privilege to appear before the Committee.

I am the President of the Committee for a Responsible Federal Budget. Our Co-Chairs are Bill Frenzel, Jim Nussle, Tim Penny and Charlie Stenholm, and our Board is made up of many of the past Directors of the Office of Management and Budget, the Congressional Budget Office, and the Chairs of the Federal Reserve Board and the House and Senate Budget Committees. I am also a member of the Peterson-Pew Commission on Budget Reform, which spent the past two and a half years developing a suite of recommendations to reform the budget process and 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, in addition to a number of other budgetary reforms, which we believe can be a helpful part of fixing our budgetary challenges.

I share the belief that I believe many of you hold, that 1) our budget process is in many ways broken; 2) there are many reforms we can and should make to improve it; and 3) none of these changes will replace the hard choices that need to be made to fix our dangerous fiscal situation. In order to do that, we need to change our spending and tax policies, and the sooner we get a plan to do so in place, the better it will be for the fiscal and economic health of the country.

When it comes to the budget process, it is simply not working. Deadlines are routinely missed, appropriations fall behind schedule and lead to budgeting in bulk, and too many gimmicks are employed to get around the few fiscal constraints that remain. Most of the budget is on automatic pilot, and the entire process lacks the thoughtful contemplation that should be part of setting our national priorities and deciding how best to fund them.

The Committee for a Responsible Federal Budget and the Peterson-Pew Commission have made a number of recommendations to change the budget process, which fall under our 3-Ts of ***Targets, Triggers, and Transparency***, which we believe would be helpful, including:

- Setting a medium-term debt target and a glide path of annual debt and savings targets to achieve it
- Using broad-based budget triggers with no programmatic exemptions to ensure that targets are met
- Following the enactment of a deficit reduction plan to stabilize the debt, using additional triggers and spending and tax expenditure caps to keep any plan on track
- Requiring the President to issue annual progress reports on the effects of all newly issued legislation and progress towards longer-term fiscal goals
- Presenting new budget allocations compared to the previous year's levels as well as other baselines
- Reforming the way for which emergencies are budgeted
- Presenting tax expenditures by area alongside other spending in the same categories
- Increasing the level of scrutiny and oversight on tax expenditures

Today, I have been asked to focus the bulk of my remarks on biennial budgeting, which is getting a good deal of interest and attention, and which the Committee for a Responsible Federal Budget has long supported. I will also touch upon an extension of this that we at the Committee are particularly interested in at the moment—multi-year budgeting.

Under biennial budgeting, the country would shift from a one-year budget cycle to a two-year budget cycle. The traditional argument for this, and one the Committee agree with, is that it frees up considerable time to devote to better oversight of current programs. Improved oversight will by necessity, I believe, become a large theme of fiscal policy going forward. One of the greatest challenges we will have as a nation, given our fiscal realities, is how to do more and how to do it better in a period of constrained fiscal resources. Oversight is one critical component of making these improvements.

Currently, we actually collect considerable amount of data on the performance and effectiveness of various government programs – though we don't do nearly as good a job at collecting comparable information on tax expenditures. However, we don't do a particularly good job of integrating the findings of these metrics into the actual budget process. More time to better integrate these findings would presumably lead to improving or eliminating programs that are duplicative, underperforming, or mis-allocating resources. While ridding the budget of

waste, fraud, and abuse is never going to fix the budget on its own and has become a talking point that for years has detracted from the real issues of spending and tax changes, it is a necessary component of overhauling our budget. Whatever we can do to ferret out waste and improve performance, we should do.

Furthermore, biennial budgeting would give federal agencies more stability and free up some of the considerable time they must currently devote to budgeting. Much like putting in place a multi-year deficit reduction plan would help businesses and families by providing them with the stability they currently don't have, biennial budgeting would add more stability to the environment in which federal agencies operate. Organizations that receive government funding for things such as basic research would also be helped in their planning efforts by having a longer budget cycle. A longer cycle could also create better managerial incentives in terms allowing agency heads to determine when over the course of two years, rather than one, they should spend down their allotted resources.

There are certainly some legitimate arguments against two-year budgeting. Many people agree that the changes would free-up resources and allow for better oversight but are concerned about how biennial budgeting would work in practice. Some degree of flexibly would be lost, for instance, as agencies would be required to make their budget farther in advance. Others worry that agencies would be less responsive and accountable to Congress once their budgets were in place and protected for the following two years.

There is also a real concern that we would see a significant increase in the number of supplemental appropriations bills, thus creating a de-facto annual budget appropriations process. But this could be dealt with by tightening up restrictions for what can qualify as supplemental spending. Supplementals should only be used in the case of emergencies or in the face of unpredictable changes, not as a means to increase spending in general budget areas. This could also be addressed by improving how we budget for emergencies.

Finally, with the recent Budget Control Act of 2011 (BCA), the nature of budgeting going forward has changed, at least for the medium-term. With the adoption of 10-year spending caps for discretionary spending through 2021 as part of the budget deal, much of the work of the annual budget exercise has already been done, providing more to the argument that the budget need not be redone on an annual basis. This recent change is likely to breathe new life into the efforts to institute biennial budgeting.

I would like to make a number of suggestions of what a second year in a biennial budget system could be used for in addition to further evaluation and oversight.

One of the obvious advantages is that biennial budgeting frees up more time for oversight. But it also would free up time for deeper studies in a variety of areas related to the budget. One possibility that we at the Committee have long supported, would be to create a budget concepts commission. Such a commission would look into a number of issues, including many of those I mentioned earlier in my remarks, such as better accounting, particularly for long-term spending programs, fiscal exposures, insurance programs, and programs that are intended to be pre-funded; improving the construction and use of budget baselines; capital budgeting and dynamic scoring issues; tax expenditures; accounting for private securities; leasing and public-private partnerships; and trust funds. As the nature of budgeting continues to evolve, a freestanding budget concepts commission would likely prove immensely beneficial.

The second possibility is to spend more time focusing on determining national priorities and developing a more detailed analysis of all government tax and spending programs that are directed towards achieving those priorities. This practice is referred to in some other nations as portfolio budgeting and focuses on connecting all the various spending and tax programs by area to their intended objective. More time would be devoted to identifying and ranking national priorities than we have in our current budget process, which would allow policymakers to be more purposeful and transparent in setting budget priorities and determining how best to achieve them.

Related to this would be using the off years to engage in broader strategic planning for the nation. Currently, not only is there no fiscal roadmap for the country, there is no broader strategic path. Efforts to identify long, medium, and short-term goals; threats and new opportunities; changes in the political and economic environment, etc. would guide policymakers as they hopefully engage in a more thoughtful budget process and allow them to take a step back on a regular basis from the nuts and bolts aspects of crafting a national budget.

Finally, we might consider producing topical reports regarding the fiscal health of the country. Australia, for instance, issues its Intergenerational Report every five years, which assess the implications of current policies over a longer time horizon and looks at the effects of demographic change on economic growth. Past efforts in the United States to integrate generational accounting have been, while technically challenging, extremely illuminating. A deeper dive into topics such as the interconnectedness between federal, state, and local budgets or fiscal exposures due to contingent liabilities and implicit budget commitments would

be immensely useful in identifying, and hopefully avoiding, future budgetary challenges. Suffice to it say, there is no shortage of ways we could use the additional time freed up by budgeting over a longer cycle.

I'd also like to take a moment discuss the possibility of a multi-year budget. Right now the country needs a fiscal plan to get us to a sustainable debt level with the debt on a declining path relative to the economy. Such a plan will probably need to span a full decade, which is a reasonable amount of time to make progress on reducing the debt to around 65 percent of GDP—though beyond that, we need to continue to make changes to bring it back closer to its historical level of below 40 percent. Ideally, we would put such a plan in place immediately and allow many of the changes to phase-in more gradually both to allow people to adjust as needed and to allow the economy to continue to recover. But in order to be credible, there has to be a real commitment to sticking to the plan in subsequent years. So if such a multi-year plan is adopted as so many fiscal experts have recommended, the policy then should be to assume that ten-year plan remains in place for the decade, though with enough flexibility to make necessary changes along the way to account for external changes that arise without derailing the overall glide path to an improved fiscal situation. One of the purposes of putting a plan in place is to reassure credit markets and rating agencies, and provide families and businesses with the stability they need to plan, invest, and help grow the economy. If this plan is seen as something that can be changed dramatically year-to-year, it will not provide that security or stability.

Therefore, the Committee for a Responsible Federal Budget is currently most focused on how to encourage the adoption of a multi-year plan with the flexibility to make adjustments as needed, but also the enforcement mechanisms to ensure that it stays on track. In addition to adding more stability, multi-year budgets have the advantage of becoming the default budget and staying in place until they are replaced with a new budget, so such a change would end the detrimental practice of missed deadlines, last minute budgeting, and near government shutdowns.

I must emphasize that regardless of budget process improvements, the single most important thing we can do to improve the fiscal health of our nation is put in place a package of policy changes sufficient to stabilize the debt at a manageable level. The Joint Select Committee on Deficit Reduction has a remarkable opportunity to put in place reforms that will help set the country on an improved fiscal path. The $1.5 trillion dollars in savings they are trying to achieve would be a significant improvement, though it is not large enough to stabilize the debt, and we believe the Joint Select Committee should work to focus on the largest problems in the budget – particularly entitlement spending on health care and retirement, in addition to the tax code –

and attempt to come up with larger savings in order to bring the debt back down to a sustainable level. Budget process reforms will be helpful in encouraging these policy reforms, and are critical in making sure they stick. However, the heavy lift will come from making the actual decisions about what spending to cut what revenues to increase, how to ensure that these changes are conducive to economic growth, and how to protect the many core principles and values that come into play as part of the federal budget.

Relying on a more rational timeframe for budgeting is one of the process changes we believe will have positive results. Accordingly, while I would urge Congress not to focus on process as a replacement for policy, biennial budgeting or multi-year budgeting would be a useful tool in helping to deal with America's significant budgetary and fiscal challenges.

Thank you again for the opportunity to testify today and to the many members of this Committee for your leadership on these critical issues. I look forward to your questions.

Chairman CONRAD. Thank you. We appreciate that.

And I will go to Mr. Kendall next, a Senior Fellow at Third Way. Welcome.

Senator SESSIONS. Mr. Chairman, as you do that, I see my colleague, Senator Enzi here, whom I count a longtime member. He has also offered legislation for a two-year budget. You made reference earlier that legislation is pending. He has got a very thoughtful plan that I know we will consider as we go forward.

Chairman CONRAD. He does and he has done very good work and we appreciate his suggestions. As we have worked to develop a proposal, we have looked very closely at Senator Enzi's work, as well.

Mr. Kendall, welcome and please proceed.

STATEMENT OF DAVID KENDALL, SENIOR FELLOW FOR HEALTH AND FISCAL POLICY, THIRD WAY

Mr. KENDALL. Thank you, Mr. Chairman. I appreciate the opportunity to testify this morning. I represent Third Way, which is a think tank that creates and advances moderate policies, and we applaud your efforts, Mr. Chairman and the rest of this committee, for working to reduce the deficit and the debt. We also welcome this opportunity to figure out how to change the budget process in order to prevent problems like we have been dealing with for the last several years.

The father of the modern industrial movement, Edwards Deming, once said a good system—I mean, a bad system will beat a good person every time. Members of both political parties, despite their differences, want to put their Federal fiscal house in order and give taxpayers good value for their dollars. But the budget process itself often gets in the way of that common goal.

A biennial budget can give members of Congress opportunities to be good stewards of tax dollars. Every year, Congress faces annual budget appropriations and battles over how to spend taxpayers' money. These fights leave little time to contemplate how to save money and use it more effectively. Unlike the annual budget process, which Congress rarely completes on time, a biennial budget would allow Congress to devote a second year to planning, oversight, streamlining government services.

A biennial budget has had many champions over the years, including Senator Enzi. In this Congress, Senators Johnny Isakson and Jeanne Shaheen have introduced bipartisan legislation cosponsored by several members of this committee.

Let me suggest perhaps, as Senator Sessions did, that the time for this biennial budget has finally arrived. Let me address three questions: How would it work, how can it help, and what needs to be done to implement a biennial budget.

As, Mr. Chairman, you have very clearly explained, a biennial budget would be devoted in the first year to enacting a two-year budget. The second session would focus on oversight of government programs, more authorizing legislation, and adjusting the budget laws for changing conditions or unforeseen events.

A two-year budget would give Congress and executive agencies a chance to develop and implement a policy with more predictability and accountability. A shift to a longer-term plan would bring government in line with well established business practices that have

been used in the private sector for decades. A biennial budget would also increase the predictability and stability for State and local governments, which rely on Federal funding and regularly enter into fiscal compacts with the Federal Government.

Some might argue that a biennial budget would leave Congress vulnerable to faulty assumptions about baselines or economic factors. It is true that a budget is only as good as its underlying predictions. But problems with predictions do not grow exponentially with longer budget periods. With a biennial budget, the prediction problem would increase only by the number of the years in the budget. According to a Harvard Law School analysis, the CBO's baseline predictions were off by an average of about 4.23 percent of total outlays for one year out and about nine percent for two years out during the period from 1995 to 2006. If a second year budget adjustments were necessary in any given year, then they could be made with far less difficulty than the repetition of the entire budget process.

In the second year of a two-year budget cycle, it would be critical to have a formal structure agreed upon and in place to ensure that needed adjustments do not simply redo all the appropriations. For example, Oregon State's legislature recently modified its biennial budget to include a plan for significant revisions in the second year of its budget year, and specifically it held back a portion of its spending as a reserve fund in case the economic downturn proved worse than predicted.

State legislatures with biennial budgets sometimes delegate limited authority to the executive branch to deal with any necessary changes during the off-budget years, but they do not relinquish control over their spending just because the budget is set every two years.

So how can a biennial budget help? By any number of measures, the budget process is not working. From 1975 to 2000, Congress met its statutory deadline for passing annual budget resolutions only five times. Over the last decade, Congress has failed two-thirds of the time to pass budget resolutions in both years of its two-year term.

For appropriations since 1996, Congress has been late an average of 86 days after the start of a fiscal year, according to the Congressional research, and as my colleague Maya MacGuineas's organization recently pointed out, in the fiscal year that just ended, we used eight Continuing Resolutions.

This reminds me of Albert Einstein's quote. Insanity is doing the same thing over and over again and expecting different results. Instead of trying something different, Congress has let the process get worse.

The threat of indiscriminate across-the-board cuts is now very real. The Budget Control Act of 2011 subjects discretionary spending to across-the-board cuts if the Joint Select Committee on Deficit Reduction, the Super Committee, fails to achieve its minimum $1.2 trillion in deficit reduction. There may be no other way to force action, but across-the-board cuts would be the opposite of effective budgeting, should those cuts occur.

A two-year budget cycle would give more time to air out more complicated issues, improve programs, and crack down on waste. It

is a natural fit in an era when every fiscal decision is going to be fraught with budgetary consequences. Biennial budgeting is not a cure-all for the problems in the budget process, but making they budget process consistently transparent and accountable will reduce the risk of political breakdowns.

So how would this biennial budget be implemented? The Isakson-Shaheen bill is a good place to start for implementing legislation. It sets a calendar for each two year budget cycle, makes necessary changes to the 1974 Budget Act, and adapts the administration's budgeting and Congress's appropriations process to a two-year cycle. In addition, each committee will have to establish a new pattern of hearings and activities during the second year of its budget cycle.

No committee's pattern would change more than the Appropriation Committees. Today, the Appropriations Committees' process is a full-year job. It leaves the Appropriations Committees with little time to make sure the money is well spent, a task for which they are surely well qualified because they know where the money has been going. Their new activities could include hearings about program results, site visits to Federal programs and offices—when was the last time that anybody that you know of in Congress actually visited a Federal agency—and then reports on these findings. These activities would also prepare them for making new decisions about the best use of Federal funds in the upcoming year.

Authorizing committees should and would continue to conduct vigorous oversight, and under a biennial budget they would have more time to do just that.

The Budget Committees would also have to define a new role for themselves. They could increase accountability and transparency in budgeting by dividing time and attention to several areas: The construction and use of budget baselines; the differing assumptions between the CBO and the 0MB; the effect of Federal budget on the nation's economy; and the disclosure of budgetary information to the public through a taxpayer receipt or other ideas. Some of these tasks could be defined in statute to ensure they are addressed.

My last quote is from General George Patton. He once said, you are never beaten until you admit it. You know, we hear a lot today about how the budget process is broken and we hear too little about it being fixed. Congress now has an opportunity to fight for a better budget process and I look forward to having a discussion with you about how to do that. Thank you.

[The prepared statement of Mr. Kendall follows:]

THE ECONOMIC PROGRAM

Statement of David B. Kendall
Senior Fellow for Health and Fiscal Policy, Third Way
October 4, 2011

Committee on the Budget
United States Senate

Thank you, Mr. Chairman, for the opportunity to testify this morning about improving the budget process. Third Way is a think tank that creates and advances moderate policy and political ideas. We applaud your efforts, Mr. Chairman, and all the members of this committee, to bring the federal deficit and debt under control. We also welcome this hearing on how to improve the budget process and very much appreciate the opportunity to testify.

The father of the modern industrial quality movement, Edwards Deming, once said: "A bad system will beat a good person every time."

Members of both parties despite their differences want to put our fiscal house in order and give taxpayers good value for their tax dollars. The budgeting process itself often gets in the way of that common goal.

A biennial budget can give good people more opportunities to be good stewards of tax dollars. Every year Congress faces annual battles over how to spend taxpayers' money, but under the current system these fights leave little time to contemplate how to save it and use it more effectively. Unlike the annual budget process, which Congress rarely completes on time, Congress would be able to devote the second year of a two-year budget cycle to planning, oversight, and streamlining government programs and services.

A biennial budget has had many champions over the years. In this Congress, Senators Johnny Isakson and Jeanne Shaheen have introduced bipartisan legislation, "The Biennial Budget Appropriations Act," S. 211. A similar bill with bipartisan support has been introduced in the House of Representatives by Representative David Dreier. This is an idea whose time has come.

I would like to address three questions about a biennial budget:

1. How would it work?
2. How can it help?
3. What needs to be done to implement it?

How would a biennial budget work?

Under biennial budgeting, the first session of each Congress would be devoted to enacting a two-year budget. The second session would focus on oversight of federal programs, authorizing legislation, and legislation needed to adjust budget laws for changing conditions or unforeseen events.

A two-year budget would give Congress and executive agencies a chance to develop and implement policy with more predictability and accountability. A shift to a longer-term plan would bring government in line with well-established business practices that have been used in the private sector for decades. A biennial budget would also increase predictability and stability for state and local governments, which rely on federal funding and regularly enter into joint ventures with the federal government.

Some may argue that a biennial budget would leave Congress unable to react to the difference between projections and performance. It's true that a budget is only as good as its underlying predictions, but that holds for both annual and biennial budgets—and prediction errors are fairly minimal two years out compared to just one. According to a Harvard Law School analysis, the Congressional Budget Office's baseline predictions were off by an average of 4.23% of total outlays for one year out and 8.84% for two years out during the period from 1995 to 2006. If second year budget adjustments were necessary, they could be made with far less difficulty than a repetition of the entire budget process.

Any adjustments for a major crisis like the Great Recession could be done by allowing the President greater latitude for making budgetary adjustments in off-years or by engaging in mid-cycle corrections. It is critical to have a formal structure agreed upon and in place to ensure that any needed adjustments do not turn into completely new appropriations bills.

For example, the Oregon state legislature has recently modified its biennial budget to include a plan for significant revisions in the second year if necessary. Legislatures with biennial budgets sometimes delegate limited authority to the executive branch, but they do not relinquish control over spending in general just because the budgets are set every two years.

How can a biennial budget help?

By any number of measures the budget process isn't working:

- From 1975 to 2000, Congress met its statutory deadline for passing its annual budget resolution only five times.
- Over the last decade, Congress has failed two-thirds of the time to pass budget resolutions in both years of its two-year term.
- For appropriations, since 1996, Congress has been late an average of 86 days after the start of the fiscal year according the Congressional Research Service.
- In the fiscal year that just ended, Congress used eight continuing resolutions as the Committee for a Responsible Federal Budget recently pointed out.

The same budget process that was used for a $500 billion budget in 1979 is still used for today's $3.7 trillion dollar budget. Each year, the budget gets more complicated and the process for passage seems more arcane. In the absence of

transparency, political fights over spending have dominated the budget debate. Budgets are passed by cutting last minute back room deals—the exact type of horse-trading strongly opposed by the public.

The complicated, highly politicized budget process has also produced the threat of indiscriminate, across-the-board-cuts. Without the opportunity for members of Congress to deal with the budget in bite-sized pieces, broad-stroke cuts have become a leading way to achieve fiscal restraints. The Budget Control Act of 2011 subjects discretionary spending to across-the-board cuts if the Joint Select Committee on Deficit Reduction fails to achieve the minimum $1.2 trillion in deficit reduction.

A two-year budget cycle would give more time to air out complicated issues, improve programs, and crack down on waste. With an annual budget, oversight is rarely a priority in part because there's barely enough time for authorizing and appropriating. Each year, valuable space on the cramped Congressional calendar is absorbed by the annual appropriations process, commanding significant attention, time, and resources from Members of Congress and their staffs. The authorizing committees are similarly oriented toward renewing, expanding and modifying existing programs.

The current budgetary process requires immense time and staff-power. These resources are strained every year as Congress debates anew issues that had seemingly limitless attention just a year prior. The same is true of executive agencies; preparing annual budgets is time not spent actually fulfilling the mission of the organization. All of this time and energy is spent focusing on the next fiscal year without incorporating longer-term financing and strategic planning. The reality is that vast resources, both in terms of human and financial capital, are wasted on repeating the budgetary process each year, a process that is needlessly short-sighted at that.

Additionally, a biennial budget would reduce the number of opportunities for inserting pet-projects into appropriation bills, while increasing the scrutiny of the way money is actually being spent. For now, the tide of earmarking for pet projects has receded, and a biennial budget would help ensure it does not rise again.

Biennial budgeting is not a cure-all for the problems in the budget process, but making the budget process consistently transparent and accountable will reduce the risk of political breakdowns.

How would a biennial budget be implemented?

The Isakson-Shaheen bill is a good place to start for implementing legislation. It sets a new calendar for each year of the two-year budget cycle, makes necessary changes to the 1974 Budget Act, and adapts the Administration's budgeting and Congress' appropriations and authorization process to the two-year cycle.

In addition, each committee will have to establish a new pattern of hearings and activities during the second year of the budget cycle. No committee's pattern would change more than the appropriations committees. Annual budgeting is a full-year job. It leaves the appropriations committees with no time for making sure the money they appropriate is well spent – a task for which they are uniquely well-suited because

they know where the money is going. Their new activities could include hearings about programs results, site visits to federal programs and offices, and reports on findings. These activities would also prepare them for making new decisions about the best use of federal funds in the upcoming year.

Authorizing committees should and would continue to conduct vigorous oversight. Under a biennial budget, they would have more time for their traditional oversight activities as well as more time on the legislative calendar for authorizing legislation.

The budget committees will also have to define a new role for themselves during the second year. They could increase transparency and accountability in budgeting by devoting time and attention to several areas: the construction and use of budget baselines, the differing budget assumptions between the Congressional Budget Office and the Office of Management and Budget, the effect of the federal budget on the nation's economy, and the disclosure of budgetary information to the public through a taxpayer receipt or other techniques. Some of these tasks could be defined in statue to ensure they are addressed.

Conclusion

Another famous American, General George S. Patton, Jr. once said: "You're never beaten until you admit it." Too often we hear the budget process is broken, and too little about fixing it. Congress now has an opportunity to fight for and win a better budget process. Third Way urges the Senate Budget Committee to propose a biennial budget as one way to help prevent the problems that the Joint Select Committee on Deficit Reduction is now addressing.

Chairman CONRAD. Thank you very much.
Dr. Kettl.

STATEMENT OF DONALD F. KETTL, DEAN, SCHOOL OF PUBLIC POLICY, UNIVERSITY OF MARYLAND

Mr. KETTL. Mr. Chairman, thank you so much for this opportunity to appear before you this morning to talk about this issue of biennial budgeting not only as a strategy to try to fix a process that, as you noted at the beginning, is broken, but to take advantage of what is unquestionably an historic opportunity. We get a shot maybe once in a generation to be able to take a careful look at what it is that we do, and there is nothing more important in government than to try to focus on the two basic questions we are dealing with today: What is it that government should do, and how well is government doing it. A biennial budget process would provide an opportunity in alternating years to look at exactly those two questions.

In addition to that is a point that we need to make, as well. That is, the harder it gets to be to focus on these fundamental questions about what we want to spend money on, the more important it is to be focusing on the questions of performance and how well government actually works.

There are a couple central arguments that lie at the core of this. The first is that less and less in the Federal budget is subject to an annual change in any event, so that an annual budgetary process is falling increasingly out of sync with the realities of budgetary decision making. And the other point is that growing economic and fiscal challenges have increased our need to look more than one year down the road, past incremental changes and to the long-term fundamental and strategic questions that face the country.

So let me try to look at three questions in particular that really frame the basic questions of biennial budgeting. First, the question of annual review of budgetary spending to begin with.

The simple fact is that less and less of the Federal budget is subject to discretionary spending to begin with. In 1971, close to the last time that we took a careful look at the budget process, 58 percent of the entire Federal budget was discretionary. Today, it is about 39 percent. So we have gone from about 60 percent to about a third that is subject to annual appropriations, and on top of that, very little of what it is that we appropriate annually can be changed annually in any event because, for example, the Pentagon, we are multi-year contracts. In many domestic programs, like air traffic control, we have large fixed costs that we do not want to change and would not be able to change in very rapid basis in any event.

It is increasingly clear that we need to focus much more fundamentally on long-term strategy and not short-term financing, and that the focus increasingly on trying to pass annual appropriations is drawing us further and further away from the questions we most need to focus on, and a biennial budget would provide an opportunity for a longer-term view on the basic issues that we need most to try to address.

Second point, that has to do with balancing budget review with a performance review. It is well known, and we all understand,

that processes alone, by themselves, cannot force action, and in particular, they cannot force attention to performance. But a commitment to biennial budgeting would put Congress on record as an institution on the importance of looking on a regular basis at how well government works and to provide an opportunity and the time for a systematic review of government's performance. It would also create public expectations and public opportunities for participation in those basic questions about what it is that government does and how well it does it.

Look simply at some of the basic facts of government's day-to-day operations. In the Pentagon, there is something like $2 to $3 billion worth of transactions that occur every day, and ensuring that that money is being spent well requires a careful and regular review.

Recent surveys have shown that improper fee-for-service operations in the Medicare program are costing the Federal Government $24 billion a year, and estimates of fraud, waste, and abuse in the Medicare program range even higher. It is certainly not the case that anybody wants to allow that to happen, but attacking those problems and wringing out those difficulties will require a careful and systematic look at Medicare's operations.

We have recently become reacquainted yet again with the difficulties we have in our food safety programs, but a careful look at how it is that food safety operates reveals that responsibility is shared with the U.S. Department of Agriculture, the Food and Drug Administration, Marine Fisheries, Customs and Border Protection, the Federal Trade Commission, and other agencies, as well, and we are not going to be able to provide to Americans the quality and safety of food that they expect and demand without a careful attention to what it is that government does.

Just a few months ago, the Government Accountability Office released a report of opportunities to reduce duplication in Federal Government and Federal Government agencies and programs, but careful attention to that is unlikely to happen without providing the time to ensure a careful review. And, on top of that, if we are just looking for a single place to start, the Government Accountability Office has provided a list of 30 high-risk programs that are especially susceptible to waste and mismanagement, and only by a careful review of those programs are we likely to be able to provide the opportunities that we need to ensure that, in fact, those problems are taken care of.

This is, as Senator Sessions pointed out, an opportunity for accountability, and most importantly, an understanding that the future and future performance really rests on the ability to be able to link performance to the budget if we are, in the end, to achieve the results that we want and deserve to give Americans.

The third point that I want to make is the importance of taking a longer time horizon to view the important questions that lie before us, and in particular, to ensure that the executive branch is provided the ammunition that it needs to be able to ensure that it manages its programs as well as it could. More predictability in Federal funding, not necessarily more money, but more predictability in the money that executive branch agencies are given will provide opportunities for more long-range planning. It will create opportunities for more efficiencies in hiring workers and in buying

supplies. It will cut in half the annual use it or lose it process that so often afflicts the ways in which government agencies have to operate.

So if we consider those three issues, that the annual budget process is becoming increasingly out of sync with the realities of Federal spending, that we have an obligation to citizens to provide more opportunity for oversight about the way in which Federal programs operate, and that a biennial budget process would increase efficiencies in the executive branch, we have, I think, a very strong case for the biennial budget.

The process is increasingly troubled, and both Mr. Chairman, as you have pointed out, and our witnesses today have explored, as well, we have had a harder and harder time getting the budget passed on time. But more importantly, we have had a harder time getting the budget to focus on the questions that are of fundamental importance. We now have an opportunity to focus Congress's attention on the right issues at the right time and the right ways. Those fundamental decisions require a longer-term view on what we do and how we do it, and focusing on how much to spend is not in itself enough, because if we focus only on that side, we will miss the opportunity to ensure we get our money's worth for what it is that we do want to spend. This is, in short, an opportunity to take the budget decisions and couple them with important oversight questions that we face and provide an answer to this historic opportunity, this once-in-a-generation chance to try to advance the way in which we deal with these fundamental questions for all Americans.

So, Mr. Chairman, I thank you very much for this opportunity to participate and look forward to our discussion.

[The prepared statement of Mr. Kettl follows:]

Improving the Budget Process:

Strategies for More Effective Congressional Budgeting

Committee on the Budget
United States Senate
October 4, 2011

Statement of

Donald F. Kettl
Dean
School of Public Policy
University of Maryland

I want to thank the Committee for this opportunity to testify on steps that can be taken to improve the federal budgetary process—and to improve the results of federal spending. In particular, shifting to a biennial process makes eminent sense and deserves careful consideration.

Let's start with the obvious—but important—point: The imperative for controlling federal spending has never been greater. Then add the corollary: There are two principal routes for reducing federal spending—deciding that we're going to stop doing things we're now doing, and eliminating those expenditures; and doing what we're doing in better ways, and achieving cost savings through higher productivity. Finally, consider the conclusion: Any budget strategy that focused on just one of these routes is doomed to failure. Congress cannot exercise control over the budget without paying careful attention both to what the government does *and* how well it does it. Indeed, the harder the decisions get on which programs to cut, the more performance improvements will matter.

That leads us to the proposal for a biennial budget. In its most useful formulation, Congress would alternate between the what and the how: It would pass a two-year budget one year, and in the next year it would carefully examine the performance of government programs. The examination of performance would then lead to proposals to refine the budget in the next year. This is the epitome of a virtuous cycle.

Evidence from the states

Many budget analysts have pointed to state budget processes and have suggested the evidence supporting biennial budgeting is scant. In fact, state budgetary practice varies widely. According to an April 2011 report by the National Council on State Legislatures, the trend at the state level

has been away from biennial budgets. In 1940, 44 states had biennial budgets. In 2011, the number had shrunk to 19. A large part of this change, however, has come from the increasing role and influence of state legislatures. In 1940, just 4 states met annually. By 2011, only 4 states met biennially. With more state legislatures meeting in annual sessions and exercising more power, more states have moved to annual budgets (although Connecticut moved in the opposite direction, from annual to biennial budgets).[1]

The lineup: 31 states have annual sessions and annual budgets; 15 states have annual sessions and biennial budgets; and 4 states have biennial sessions and biennial budgets. What is the evidence from the state experience?

- *Administrative costs.* Biennial budgets, naturally, reduce the administrative costs of budget preparation. If the budget is prepared half as often, budget analysts don't have to invest as much time in the process.
- *Legislative investment.* Evidence that legislatures spend less time on budgeting in states with biennial budgets is less clear, since in states with biennial budgets the legislature often returns in the second year of the budget cycle to pass supplemental appropriations.
- *Budget forecasting.* States with biennial budgets must often return to forecasts as economic conditions change. That, in turn, often requires budgetary adjustments and, sometimes, more supplemental appropriations.
- *Long-term planning.* Evidence is inconclusive on whether biennial budgets improve long-term strategic planning in the states.
- *Performance evaluation.* There is weak evidence that biennial budgets improve states' attention to the performance of government programs, but there is modest evidence suggesting that the underlying assumption—more time available for oversight in fact produces more oversight—might be true.

The author of the NCSL study, Ron Snell, concluded that he could find "no convincing evidence that the length of the budget cycle, in itself, determines how efficiently a state enacts a budget and whether it requires extensive change during the course of its administration."

Evidence from other countries

Among national governments, annual budgets are the norm. This appears to be the result, most often, of long-standing practice and the structure of political institutions, in which the

[1] Ron Snell, "State Experiences with Annual and Biennial Budgeting" (April 2011), at http://www.ncsl.org/default.aspx?tabid=12658

government of the day prepares the budget for parliamentary review. Spain and some other countries with Spanish histories have had biennial budgets. Annual budgets are the more common practice. The International Monetary Fund's "Code of Good Practices on Fiscal Transparency" (2007) anticipates the use of annual budgets by developing nations.[2]

Arguments against biennial budgets

Budget and policy experts have often been lukewarm about biennial budgeting. In 2006, for example, Robert Greenstein and James R. Horney argued that biennial budgeting would force Congress to make too many financial decisions too far in advance, force their reliance on economic projections that could be subject to significant changes and therefore create decisions on a less-reliable set of assumptions, create a strong presumption in favor of the status quo and make it hard to shift fundamental budget priorities, and lead to frequent revisions.[3]

The case for biennial budgets

These arguments deserve careful consideration. However, it is also important to note the following:

- Compared with state governments, less of the federal budget is subject to annual review and change.
- Growing economic and fiscal challenges have increased the need for looking past annual incremental tinkering and focusing more on longer-term strategic questions.

In the face of these issues, what is the case for a biennial federal budget?

1. A biennial budget would increase attention to the fundamental budgetary decisions. As federal expenditures for entitlements rises, the share of federal spending subject to annual (or biennial) budget decisions has been steadily shrinking. Federal outlays for discretionary spending have gone from 58 percent in 1971 to 39 percent in 2010. That's just a bit more than a third of all federal spending—the rest is accounted for by entitlements and interest on the debt. Discretionary spending is subject to annual appropriations, but much of it cannot be changed annually. Much defense spending is locked in through multi-year contracts. Many domestic programs, like air-traffic control, have relatively fixed costs not subject to significant annual adjustment. Congress might well have an annual budget, but a very small share of current spending is annually budgeted.

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[2] See http://www.imf.org/external/np/fad/trans/code.htm

[3] Robert Greenstein and James R. Horney, "Biennial Budgeting: Do The Drawbacks Outweigh The Advantages?" (June 11, 2006), at http://www.cbpp.org/cms/index.cfm?fa=view&id=394

This creates a series of fundamental paradoxes: more of the annual budget process is focused on less of the budget; more of the budget is not subject to annual budgetary review; and Congress spends most of its budgetary time on budget elements that are making less difference in basic budgetary strategy.

It might be true that biennial budgeting would force Congress to make more decisions in advance of rapidly changing conditions. But the really fundamental decisions require just that—and focusing on annual decisions is giving Congress decreasing leverage over federal spending. A regular focus on the big decisions, instead of more-frequent review of the small decisions, would enhance Congress's fiscal control.

2. Congress would commit itself to regular review of program performance. Congress can, of course, conduct as many performance reviews now as it chooses, without a change in the budgetary process. Not only is there no impediment to doing so—a series of major initiatives, led by the Government Performance and Results Act, require federal agencies to supply performance information to Congress. Despite this, however, congressional attention to the review of government performance has been sporadic at best, with limited impact.

No new budgetary process can, in itself, change the incentives for the review of performance. Congress does not have to do what it chooses not to do. There is little evidence that it is the lack of time that hinders congressional attention to performance and, therefore, no strong argument that providing more time, every other year, will in itself increase congressional scrutiny of performance.

However, if a new biennial budget process commits Congress to a biennial review of performance, there could be two salutary effects. First, it would emerge as a result of a series conversation of Congress with itself about its goals and priorities. Second, in making a public stand in favor of more performance reviews, it would issue a strong invitation to the public and the media to join in the conversation about how to make government work better. Those two things could help shift the incentives for more performance reviews.

Add to that a third, inescapable fact: the need for stronger review of how well the federal government works, and a close examination of what can be done to help it work better, has never been more important. We will inevitably deal with part of the budget crisis by deciding to do less. But, for those things we decide to keep doing, we will need to take on a growing responsibility for ensuring those things are done well.

Consider, for example, the need to save money in the defense budget. The department's deputy inspector general, Daniel Blair, recently told Congress, "From the contract officer level to the contract officer on the ground, the more improvement in regulation and oversight of contracts, the more we will know about how we are spending the taxpayers' money." The Pentagon's

business systems manage transactions totaling $2 to $3 billion per day.[4] Making that process work well is an essential part of making good on the government's responsibility to taxpayers.

Consider the Medicare program, where the Centers for Medicare and Medicaid Services estimates that improper payments in its fee-for-service operations cost more than $24 billion per year.[5] Everyone agrees that this problem has to be solved, but if it were easy to solve it would have been done long ago. Only strong and concerted attention to rooting out improper payments, led by Congress, will make it happen.

Consider the complex network of federal agencies responsible for food safety, including the U.S. Department of Agriculture and the Food and Drug Administration, as well as the National Marine Fisheries Service, Customs and Border Protection, and the Federal Trade Commission. The fragmentation in this combination of agencies puts the health of Americans at risk.

Consider the Government Accountability Office's 2011 report on opportunities to reduce duplication in federal programs.[6] The report is an invaluable catalog of actions that could produce significant cost savings and program improvements.

Consider the 30 programs on the Government Accountability Office's high-risk list.[7] Together they paint a portrait of programs susceptible to tens of billions of dollars of fraud, waste, and abuse. Any serious effort to improve government's performance—and to control federal spending—must use this list as a road map.

3. A longer budgetary time horizon would create significant benefits for executive-branch agencies. Current budgetary practice contains several pathologies that reduce the performance of executive-branch agencies and drive up their costs. Greater predictability in their funding would allow more long-range planning, which would in turn create the opportunity for more efficiencies in everything from the purchase of supplies to the hiring of workers. It would cut—in half—the end-of-fiscal-year race to spend use-it-or-lose it dollars.

In recent years, there is ample evidence that Congress's inability to pass appropriations bills on time has forced start-stop-start-stop management practices that has undermined the effort to produce better government services at lower costs. More predictability in the flow of funds to

[4] Charles S. Clark, "Better Oversight of Contracts Called Key to Repairing Pentagon Ledgers," *GovExec.com* (September 23, 2011), at http://www.govexec.com/dailyfed/0911/092311cc1.htm

[5] U.S. Government Accountability Office, *Medicare Fraud, Waste, and Abuse: Challenges and Strategies for Preventing Improper Payments*, GAO-10-844T (June 15, 2010), at http://www.gao.gov/new.items/d10844t.pdf

[6] U.S. Government Accountability Office, *Opportunities to Reduce Potential Duplication in Government Programs, Save Tax Dollars, and Enhance Revenue*, GAO-11-318SP (March 2011), at http://www.gao.gov/new.items/d11318sp.pdf

[7] See http://www.gao.gov/highrisk/risks/high_risk.php

agency managers would allow them to plan far better how to make the most use of the tax dollars Congress provides.

Conclusion

Biennial budgeting is surely no panacea. No process can ever force decisions that individuals don't want to make. It cannot, in itself, force more attention to the performance of governmental programs.

It cannot make long-term budgetary projections more certain. Congress will, inevitably, still need to make mid-course adjustments to federal programs, just as it does now. But a longer-term view could well help Congress focus more on the fundamental strategies than on short-term objectives. At a time when sorting out long- and short-term views has never been more important, that could prove an important step.

A biennial budget will not eliminate the need for supplemental appropriations. Even with annual budgets, supplemental appropriations are a regular and inevitable part of the budgetary process. That won't change and there's little reason to believe it will make it any worse.

Most important, the current process cannot force the change that the budget badly needs: a switch from bifocals to telescopes—from a focus on myopic short-term concerns to far-away longer-term issues. There's growing evidence that the current budget practice is trapped in a rut that makes it hard to look beyond the very near term. A biennial budget could well help force at least a slightly longer view of the issues that matter most and, thereby, strengthen governance and financial decision making.

The congressional budget process is unquestionably struggling. In 1974, Congress decided to move the start of the fiscal year from July 1 to October 1 (starting in fiscal year 1977), to give it more time to complete its work. Congress last passed all 13 appropriations bills in 2006, and then many were well past the October 1 deadline. Congress last passed all the appropriations bills on time in 1994.

But three things are clear. First, the current budget process is not focusing Congress's attention on the right issues at the right time in the right ways. Second, the fundamental budget decisions we need to make require a longer-term view, with a careful look at what we as a national want to invest our money in. Third, focusing just on how much to spend isn't enough—we need to ensure that we get the most productivity from the money we spend.

A reformed budget process, in which Congress promises itself and the American people that it will alternate between a careful review of what we are doing—the budget—and how well we are doing it—performance—offers a real hope for charting the course we need to take in the decades ahead.

Chairman CONRAD. Really good. I appreciate very much the testimony of this panel.

Let me just say, we are going to do five-minute rounds because we have a second panel today, and I will adhere to it myself.

Let us start with the fundamentals. We are borrowing 40 cents of every dollar we spend. Revenue is the lowest it has been as a share of the national income in 60 years. Spending is the highest it has been in 60 years as a share of our national income. We have got a problem.

And, Dr. Kettl, I like very much your formulation with respect to focusing on the things that really require our attention. Increasingly, domestic discretionary spending is consuming a smaller and smaller share of the budget. Mandatory programs—Social Security, Medicare, and the rest—mandatory programs are growing dramatically as a share of the budget, and the annual budget process here is almost exclusively focused on the smaller part of the budget.

What is wrong here? We are not putting our time where the dollars are. And, of course, this is a change that has occurred gradually over time, and so it is not surprising that we have a process that really is focused on what used to be, not on what is.

If we are to focus on what is, I think it would become abundantly clear that our problem, our challenge is on the mandatory side of the ledger—Social Security, Medicare. We can see it just as clearly as can be. We had hearing after hearing in this committee going at those fundamental questions. What are we going to do about Social Security? What are we going to do about Medicare? We know we are on an unsustainable course. The demographics do not lie. The number of people who are eligible for these programs is going to double over time and we have not made the fundamental changes necessary to meet those new realities. That takes time. It takes focus. And we need to give this committee a chance to do that.

Let me go to the second point, and that is the oversight, because I think we have got pretty strong consensus—I cannot speak for everybody here, but I think we have got very strong consensus going to two years. I think the question that we have to resolve is what do we do with that second year? How do we structure the oversight? And I would be interested in any recommendations that members of this panel have with respect to the oversight component. How would we manage that second year? And I would ask each of you, in turn, for your observations on what we do that second year. Maya, we can start with you.

Ms. MACGUINEAS. Okay, Senator. I will start by saying I just could not agree with you more on where the focus needs to be in the budget, of course, that the fact that we spend so much time every year with these knock-down, drag out fights, and if the American public understood what a small share of the budget we are discussing while the part that is out of control is sort of going without that necessary oversight, I think they would be shocked. We need to turn that on its head and we need to focus on where the problems are.

In terms of the second year, I do think there is always more room for more metrics, more cost-benefit analysis, more oversight, collecting the data. But I think the most important place is to

think about how you actually integrate what we already have into the budget process, and I think that this exercise of putting out national priorities, ranking national priorities—and this is an exercise that other countries go through in a much more rigorous way than we do. They actually kind of map out, okay, in health, what are our primary objectives? Is it longer life expectancy? Is it improving quality per dollar? However you describe that, and then mapping all your health care problems and—your programs, excuse me, and see how they lead into that priority, as you have stated it, and how effective they are and where the overlap and redundancies are.

And you can almost see a visual of kind of taking our Federal budget and remapping what the different parts of it are doing, and a critical piece of this is bringing in tax expenditures. That is like the shadow budget that gets no oversight. Nobody pays attention to the $1.3 trillion in spending going through the tax code and what is working and what is not and what is being done. If you just look at housing, for instance, our housing policy is all in the tax code. It is not on the spending side.

So breaking these apart by topic, ordering our priorities, and then seeing what is working and what is not, I think, would be a new way to turn this on its head and use those oversight metrics for a greater purpose.

Chairman CONRAD. Good thoughts.

Mr. Kendall.

Mr. KENDALL. Let me agree with everything that Maya has said and add just one, which is a careful examination of baseline budgeting. I think that there is a lot of confusion in the budget debate over projections for the baselines. We have competing groups doing competing baselines. We have CBO doing a great job of producing both a current law baseline and a projected alternative baseline. But there is little discussion about what our baseline is.

And so in the off year, especially for the Budget Committee, that would be an ideal topic to really fully flesh out and figure out what should be the assumptions about a realistic baseline.

Chairman CONRAD. I am glad you mentioned that, because I think this is one of the places that there is more tomfoolery going on around here than in any other place. There are more bodies buried in these different baselines than in any other place and it absolutely is used to fool people and I have seen it consistently.

Dr. Kettl.

Mr. KETTL. Senator, I could not agree more with what I have heard, and let me just tick off maybe five very quick things that could be the focus of hearings and investigation.

The first is that every administration for the last 25 years has had its own management plan, its own performance efforts, and a careful and systematic look asking the administration, regardless of party, to explore and justify what it is that it is doing, explain what it is that it is doing and how it works is an opportunity.

Second is the Government Performance and Results Act requires all Federal agencies to define their goals and to produce performance targets, and a careful look at how well that is working is an opportunity for the committee's work.

The third is that there are some high-value targets that are out there. There, for example, have been substantial efforts made in the Medicare program to improve the purchase of durable equipment, or put differently, to ensure that as we provide wheelchairs for senior citizens, we do not pay more than we should, and there has been great success there. And examining what it is that is working and where the opportunities are for getting cost savings is something that we can identify.

The fourth point is that people do not live in government agencies. They do not live in government programs. They live in their communities and what they want is those programs to work where it is that they live. And thinking about the way in which different government programs and cross-cutting factions come together in individual communities and work or do not work, looking at government from the bottom up as well as from the top down, is an opportunity.

And then, finally, a careful and systematic look at what it is that is working so that occasionally, at least, we can identify practices that offer the most promise provides opportunities, as well, for moving the ball forward in addition, I think.

Chairman CONRAD. All right. Thank you.

Senator Sessions.

Senator SESSIONS. Thank you, Mr. Chairman.

We certainly face challenges, and every step we can take that will make our situation better, we should take, and you are on something, I think, that is a good step in the right direction.

You know, we talk about entitlements. We often think primarily of Social Security and Medicare, but there are other entitlements as part of that 60 percent, for example, Medicaid and Earned Income Tax Credit, Food Stamps. We looked at the numbers as we were seeing what the automatic reductions would be if the Committee of 12 did not reach an agreement. It would call for about a 20 percent cut in Defense, 15 to 20. Defense has had an 84 percent increase over the last decade in baseline budgeting, which is significant, but Food Stamps has had a 300 percent increase. Medicaid has had a 113 percent. Those are totally protected in this sequester. Neither one of those would have any reduction in spending if the committee does not reach an agreement.

So, somehow, we need to be more thoughtful about what we are doing here, and I just would point out that the President proposes for next year a 13 percent increase in the Department of Education, 9.5 percent in the Energy Department, and 10.5 percent in the State Department. So there are savings to be made in the nonentitlement programs that could be made.

Mr. Kettl, you made note that other countries are using two-year budgeting. I was with Senator Kyl and we were in Israel and they have gone to a two-year budgeting process. He was telling me their Finance Minister recently told him that that change was a tremendously significant part of their successful negotiation of this recessionary period we are in. Have you had a chance to hear about what they have done?

Mr. KETTL. Senator, I have not had a chance to look at Israel, but I have just come back from a series of trips to the United Kingdom, Australia, New Zealand, and even China, and in each of those

cases, the governments are spending much more time, first, focusing on the bottom line. What is it that really matters and which balls do they most want to move?

The second is what kind of metrics are they using to try to identify the performance of their programs? They are having a serious conversation with themselves and with their citizens about where they want to go and how they will know whether or not they have gotten there. Even in New Zealand, where they are struggling with trying to recover from the earthquake in Christchurch, they have a fundamental strategy of ensuring that government is woven together so that as they rebuild the community, they do not use scarce resources and programs that do not work.

It is a fundamental understanding that is happening around the world that increasingly, as resources get tighter, that we not only have to figure out what we want to do, but ensure that every nickel that we spend is spent in a way that produces productivity and results and performance, and it is one of the things that, as you travel around the world, is inescapable. The focus on government performance has become one of the truly universal pieces of globalization on the governmental side of the equation and it is a place where we have substantial opportunities in this country to catch up.

Senator SESSIONS. I agree. You know, our government is a part of the productivity of America. It is a real part of it. And to the extent to which we make it more productive, leaner and efficient and produce more per taxpayer dollar, we have made America a stronger place. It is just no doubt about it.

Ms. MacGuineas, have you had any insight into other countries or States that have had a positive result from two-year budgeting?

Ms. MACGUINEAS. Yes. All the case studies that we have looked at in the past, and as I said, we have been supporting biannual budgeting for many, many years, have always been—I think Senator Conrad's kind of pros and cons of it really mapped it out. So it makes sense for so many reasons in terms of the stability that it adds, the extra time for oversight that it adds.

Some of the disadvantages are that it is harder to know exactly what will happen in the second year, so you build in the right amount of flexibility to make alterations as you need to while also making sure that those do not become loopholes by throwing too many things in supplemental packages.

So I think what you see from looking at other countries and the States—and it is no surprise that so many former Governors who come to the Senate are big fans of biennial budgeting—is that the pros, I think, clearly outweigh the cons and the cons have some very easy ways to address the shortcomings of the biennial budgeting.

Just on one point about your triggers, or your sequesters, I think it makes so much sense that the sequester we have now is imperfect in that you either want a default that is good policy, if Congress does not do this there is a good policy that is in place to take it, or that is really, really bad policy. But what we did is we kind of put this hybrid in where it is terrible policy to have across-the-board security cuts or other cuts, but we have exempted programs for the poor in the way that make it kind of less painful, and it

is just—it is not the most effective trigger. And we have recommended something that would be across the board on all programs so that Congress would clearly not want to let it happen and force Congress to make the proactive decisions about how really to more thoughtfully make the fiscal changes we need to make with the threat of sequester pushing, making the extra pressure there.

Senator SESSIONS. Thank you for you and your group's active participation in these important issues. You have been a very valuable contributor.

Thank you, Mr. Chairman. My time is up.

Chairman CONRAD. Thank you, and I just want to say, you know, every time I drive into the garage—I guess it is one of my pet peeves—and I see all these Federal vehicles, it gets me upset. And I wonder: Who is driving all these vehicles? How can it be that we have got all these vehicles? And, you know, in the Commission, we took a big swack at that, and in our Group of Six, we said cut this 20 percent. I am not sure we could not cut it 50 percent and not have an adverse impact. But these are the kinds of things, you know, a level of detail that you could get into in a second year that is really needed.

Senator Begich.

Senator BEGICH. Thank you very much, Mr. Chairman. I would just add, Ms. MacGuineas, also say as a former mayor, mayors believe in 2-year budgeting a lot more, I would say, than Governors at times because of their legislative sessions. But I would say this: Mr. Chairman, I am not sure whether there is disagreement on a 2-year budget, so, you know, of course, I am going to ask about how the process would work. I would love to see a bill attached to some appropriation bill that we move forward in some form to just not have the debate, just get on with the show. But your issue that you just brought up on vehicles, I will tell you, the city of Anchorage, we went to 2-year budgeting when I was mayor, and many issues we spent the second year evaluating and reviewing. As a matter of fact, vehicles was one of them. We actually converted our vehicle program into a vehicle rental program that agencies would rent from within, and you would be amazed how quickly they suddenly realized that maybe they did not need that vehicle anymore because it cost them per day, per month, per year to utilize, and it was not just another vehicle laying around. We cut our vehicle utilization by almost a third in a city of 270,000 at that point. Real money was saved.

We also compared it to the private sector rental rate for the same vehicle, so our rental agency within had to be competitive. If not, the deck would change rapidly. So it does create the second year a lot more analysis and review and debate and discussion, which I think is important.

So I hope even in this cycle that we take—I cosponsored the Isakson and Shaheen bill. I am happy to look at any 2-year bill, and how we use the mechanism of the Senate to get it done rather than talking about it. But the real question to this panel: In every government except the Federal Government, we have an operating budget and a capital budget. One is partially debt financed in cash; one is straight cash, operating straight cash, utilization of operation dollars.

It is a huge leap for this place here to even think about it, but it seems that, for one, the public understands that a lot more because they deal with it. When they vote for property taxes or do not vote for property taxes, when they support an operating budget in their local communities or school expansion, people understand that. They have no clue how this place operates let alone, I think, many of the people who work within this environment understand how it operates.

Give me your thoughts on an operating budget versus a capital budget, and capital or longer term, you know, those can be 5- to 10-year plans where operating can be a 2-year but still incorporate in your 2-year budget. And maybe not take the big piece, but maybe sample it with a couple agencies and say, okay, you are going to go onto a 2-year operating and capital budget presentation to the budget process. Give me your thoughts on that.

Ms. MACGUINEAS. Well, I will tell you, in principle, I think there is absolutely no arguing against it. There are things that make sense to borrow for and things that do not make sense to borrow for.

Senator BEGICH. Right.

Ms. MACGUINEAS. And differentiating between those two would lead us to much more sound policies. I remember a number of years ago I tried to look through the budget and see how much was consumption and how much was investment, and I think I came up with about 84 versus 16, depending on how you would look at those things.

Senator BEGICH. Right.

Ms. MACGUINEAS. And that should be turned on its head. What we want to do is create the incentive to change our budget from a spending-oriented, consumption-oriented budget to an investment-oriented budget.

I am, however, incredibly worried about doing it in practice in that it is sort of like dynamic scoring, that we know that different policies do have—tax policies have different effects on the economy. But I am not sure we have the tools to rigorously and honestly differentiate them and say what would promote growth and what would not. So the concern about capital budgeting has always been: Do you start pulling more things? You know, this farm subsidy is actually an investment. More consumption-oriented things go there.

Senator BEGICH. Let me define it how local governments define it and how State governments define it. I build this building; it is capital budget. I pay for the staff; it is operating budget. Tax incentives are operational to the operation of the government. It is not a capital investment. Now, some would argue if you give an energy credit, is that a capital investment? I am talking about it in its purity as done on the State level and the local level.

Ms. MACGUINEAS. And I think that answers sort of the first concern, which is if you can define it rigorously, that improves the way it works much more.

Senator BEGICH. Good.

Ms. MACGUINEAS. The only other concern I have is right now our borrowing is so massive, we actually need to focus on how we borrow less, not how we borrow for different things. So I almost feel

like this would have been an ideal change to make in a time of more fiscal sanity where now the focus has to be on how to borrow less and to shift what we are investing in. So I do share the objective.

Senator BEGICH. Okay.

Mr. KENDALL. Senator. I think that is an excellent question, and I think it is something we constantly would want to develop as you go along, because one of the things that drives our economy is the investments by the Federal Government in research, in new technology, and, you know, infrastructure. So we have to figure out—I think it would actual help if we had more confidence in our ability to do capital budgets, even if we did not call them that, to sort out the debt problems, because right now, just cutting back on the debt looks like we are just going to cut back on economic growth.

So what I would suggest, as you just did, is let us take some agencies that are willing to step forward, that need long-term planning. The Defense Department would be a great example.

Senator BEGICH. Transportation

Mr. KENDALL. Transportation, exactly, and infrastructure banks, that kind of activity, would be great ways of testing out that concept. And then also, as Maya suggested, having a budget concepts commission, using that to develop a capital budget, because we know that debt financed investments in our country's future are key to economic growth.

Mr. KETTL. Senator, you have really identified the crucial problem here because if individuals and agency managers are allowed to express things in terms of investment, everyone is an investment. We invest in our people. We invest in our staplers. We invest in our paper. Everything is an investment. Then if that becomes an excuse for capital long-term borrowing, then you lose complete control over things, which is about where we are now.

There are two concepts that I think make a great deal of sense. One is precisely what you suggested, at least on a pilot basis, of identifying items that have a long, useful physical life, and then identifying a way to try to put our borrowing patterns against that. What State and local governments do is they do not borrow for 150 years for a bridge that will last 20. They do not borrow for 50 years for a fire truck that will last 10. They find a way to try to match up their revenue streams and the borrowing to match the useful life of the goods and services that they are buying, and that makes a tremendous amount of sense.

But connected with that has to be a second piece, which is a simple conversation with ourselves and with the American people about what is the result of what it is we spend our money on, that we have to be able to couple how much we are spending with what it is that we are getting for what we are spending. And a two-part process, being able to sync up the-revenue streams with expenditures, and then a frank conversation about what is the value of what we are doing, what results do we get for the money that we spend, is something that the American citizens expect, I think.

Senator BEGICH. Thank you very much.

Thank you, Mr. Chairman.

Chairman CONRAD. Thank you, Senator.

Senator Johnson.

Senator JOHNSON. First of all, thank you, Mr. Chairman, for holding this hearing. This is incredibly important, and I think one thing I am encouraged by is I do not think you have much argument, within this room at least, and I would think within the Senate, of actually reforming this budgetary process.

As a manufacturer and accountant myself, I realize that if you have a broken process or something out of control, you are going to have a very bad product, and we have been having a very bad product here. So I would encourage you to let us move forward with this quickly, let us get this actually passed by the Senate. We need to restore some confidence in Congress and the American people, and this would be one way we could actually do it because this is important. We are bankrupting our country.

I want to agree with Senator Sessions that the root cause of the problem really is that we have a $3.6 trillion a year entity here. And to Senator Begich's point, it is impossible to get your arms around this thing. And one of the reasons it is impossible is we do not have audited statements. If there is a balance sheet for the Federal Government, I have not seen it. We have unfunded liabilities that we are not accounting for, to your point, Ms. MacGuineas, about better accounting. This is a mess, and we do need to reform it.

But I think one of the things that we are all talking about, biennial budgeting makes sense. There is just not a whole lot of argument, so we need to move forward on it.

But I would propose some other reforms I would like to get some comment on: zero-based budgeting versus baseline. It is shocking that my calculation is it is about 30 percent of the budget, about $1 trillion, $50 billion—forget the overseas contingent—is subject to appropriations. Everything else is on automatic pilot. I do not think we would be in this position if we were appropriating all the entitlements, all the mandatory spending, and actually tweaking the programs like businesses have to do with health care. You know, every year you have to maybe increase your deductibles to make it affordable. So I think that is important.

I think we should bring on every part of the budget on the budget to be evaluated, to be appropriated, and as long as we are talking about entitlements, how making sure that they are solvent for 75 years, instilling that type of discipline?

So let me actually start asking a question here. In terms of biennial budgeting, is there a State model—let us not reinvent the wheel here. Is there already a law on the books somewhere that works really well that has taken into consideration the cons and corrected for those things? Anybody who knows.

Mr. KENDALL. Most States started off with biennial budgets because they met every other year. And, in fact, what has happened over the years is that as some States have gotten bigger, they have actually gone to annual budgets. So what you see at the State level is lots of back and forth, and so there is no—and it partly is due to political circumstances; partly it is due to the changing nature of the relationship between the legislature and the Governor. So there is no perfect model out there. I think that the Isakson-Shaheen bill covers a lot of territory. I think that is the one that we could point to. But certainly a lot of States like Arizona have re-

cently adopted biennial budgeting, and Oregon. Those are the two States that come to my mind.

Senator JOHNSON. Okay. Let me ask a question in terms of the year you would actually implement the budget. I think the Isakson-Shaheen budget actually passed the budget the first year of a Congress. I would make the suggestion, being a new kid on the block here, I would actually rather do the oversight the first year as a new Member of Congress so you can actually learn the process and then budget in the second year of a Congress. I just kind of want your thoughts on that. Dr. Kettl.

Mr. KETTL. Senator, one of the things that I will say is that budget decisions are always best made from the base of knowledge of how well things are working. It is in part a process of planning looking forward, but it is also a way of trying to look at what it is that has happened and to try to make sure that we make the investments in those things going forward that are most likely to work. So to that measure, budgeting is in part looking in the rear-view mirror and in part looking down the road with the headlights. And it has got to be balanced, especially for new members coming in. As you point out, having some sense of what it is that we are actually trying to do, how well we are actually doing it, and what implications that has for the spending we have for the future makes a lot of sense for figuring out how to move forward.

Senator JOHNSON. Ms. MacGuineas.

Ms. MACGUINEAS. I was just going to say yes, yes, and yes to all of your ideas, so I think it makes an awful lot of sense to get familiar with the performance of the various programs before you engage in the first year of budgeting.

To your two other ideas, not in biennial budgeting, I mean, budgeting from the bottom up makes a tremendous amount of sense because we have so many things—we see this all the time—that become entrenched and are just the status quo, and that is why they remain in the budget rather than having to justify them over and over again. And as in my remarks I mentioned, I think we—and we recommended in our Peterson Pew commission—you really do want to compare your annual spending and allocations to where you were last year, perhaps as well as other baselines. So I think it is very important to understand what a current services baseline would be, sort of how much to get the same amount would cost in the budget.

But, yes, a cut needs to be able to be a cut right now, and right now, with the way we budget, when you are increasing spending, it gets called a cut, and that is very confusing for people who are trying to understand. Or when we are talking about how much do we need to save to stabilize the debt. The number you normally hear is $4 trillion. That is right, depending on what it is compared to. Given all the baselines that are out there, that could be give or take trillions.

And then just to your final point, in terms of bringing everything on budget and mandatory spending, a number of us through various fiscal seminars have looked at different ways to add more discipline to the mandatory part of the budget and put in kind of longer-term caps that would help us put a budget in place for these programs, review whether it is on track, and certainly the standard

of sustainable solvency is something that should be applied to any program where it can be, in particular Social Security.

Senator JOHNSON. Mr. Chairman, if I may, because this is to your point about multiple baselines, that is an incredibly frustrating on my part. There is no unified set of numbers. I do not have a clue what number we are really looking at.

Just a quick question. How do you unify that? And what should be the agency to unify that in?

Mr. KENDALL. That is a big question, but let me just offer one short thought. The CBO now creates an alternate baseline which they project is the most likely political scenario. That is full of political assumptions. That should be tested with you all here. I think that is where we should have—because the current law baseline, which assumes that the tax cuts are going to expire, is not a realistic assumption. That is not a realistic baseline budgeting process. So we have to have a political discussion about what the baseline is, and, in fact, I think the discussion of the baseline then becomes a discussion of what the budget is. And I think that is what is missing in this debate right now.

Senator JOHNSON. Thank you, Mr. Chairman.

Chairman CONRAD. Senator Enzi.

Senator ENZI. Thank you, Mr. Chairman. As the other accountant, this is about as exciting as legislation gets. [Laughter.]

This is probably better than watching ESPN. Somebody mentioned a number of times what States are doing this biennial budgeting, and, of course, I am from Wyoming, and there have been several years that Wyoming is the only State that had a budget surplus, and at the moment they are one of six that have a budget surplus, and they do biennial budgeting.

I want to thank the panel. It has been extremely enlightening already. Ms. MacGuineas, I liked your call for better accounting. The interconnect with the Federal, State, and local, that is something we never do. Multi-year planning and by objective and that stays in effect until the objective is reached.

Mr. Kendall, you wondered about actually visiting agencies. I have done that. I like to do process audits and see how they operate. When I was running, I said we really ought to ask all the agencies who their customer is and what they think they are doing and how we would know if they got it done. Now, I have had to change that last one because no agency ever figures on being done because that means they would lose their job. But I got back here and was pleasantly surprised to find that we have a Government Performance and Results Act, which means all the agencies are supposed to be doing that already. Unfortunately, nobody is evaluating it. Well, occasionally a President will say, you know, these are agencies that failed their Government Results and Performance Act by their own evaluation, and so we ought to eliminate them. But we never do.

So I get real excited when we talk about, as Dr. Kettl did—and everybody, actually—capital budgeting. Mayor Begich—and we are both mayors and have that distinction between the capital budget and operating budget. He mentioned a specific example on vehicles and matching revenue streams. I have tried to get a capital budgeting bill through before, and Senator Corzine was actually on a

commission before he became a Senator for doing capital budgeting. I think it is absolutely essential that we split those out. And, Dr. Kettl, I loved your comment that people live at the local level. They really do not live in Washington.

I have a proposal for a biennial budgeting bill, and the reason that I developed this proposal was there seems to be a lot of concern by the appropriators, and even by the budgeters, about what kind of publicity we will get in the off year. So I split the appropriations process into two parts. When you are dealing with trillions of dollars, you ought to have more time to spend on the actual spending than what we have been doing. When we are trying to do trillions, it is really hard to even concentrate on a billion dollars. But when people start doing amendments that deal with a million dollars, people get pretty disgusted because of the time that it takes and the amount of time that there is to do all 12 budgets every year.

So I broke it into two parts, with defense being done every year but then the other two sections being done so that the first year after the election you handle the more difficult issues, and the second year you handle the ones that are a little easier because you do not want to get into politics, particularly not into Presidential politics. But that would allow us to get more details.

One of my first frustrations was with Yellowstone Park. They were always running out of money in August, and I could not figure out why. So I asked to see their budget. Their budget was one line in the Federal budget. It was $18.7 million, 155 employees. And so I wanted a little more detail on that, and there is no more detail on that. You cannot even get a list of what expenditures they have made in the past to see what they are spending their money on.

So even if you have an intense interest in a particular agency, there is no time to really do it. And so I think that the agencies would have the same level of exposure if they did half of it each year and oversight on the other half during that same year. I think that would allow us to get into more details and would actually force people to have more details. But the big thing that people comment on is will the agencies be able to plan for 2 years. I certainly hope so. They certainly cannot do much planning when we have a massive appropriations, omnibus appropriations bill. But there is a suggestion that there would be numerous supplemental bills. Do you think that would be the problem with a biennial budget, any of the proposals of biennial budgets out there? Anybody.

Mr. Kendall. Yes, you have to find a way to sort of control that impulse. You have to allow for changing circumstances. No budget predictions are going to be perfect. So having some money set aside as a possible contingency fund would be really helpful. Having more funds that are designed for disaster relief, then have them specifically laid out can help with that. Having clear rules about what constitutes supplemental—we have tightened up those rules in the Budget Control Act for emergency spending. So those kinds of things. I think you just have to define a set of rules and then see what works.

What I think is the worst thing to do is to start a new budget process and then kind of wait another 20 years to reinvest it, be-

cause that is what—we need to fine-tune this a lot more as we go along.

Senator ENZI. Yes. Well, my time has expired, and I apologize for—but I do think it would lead for better planning, and I have always contended that, since we know there is $7 billion worth of disasters every year, that probably ought to be a part of the process.

Chairman CONRAD. Thanks, Senator.

Senator Whitehouse.

Senator WHITEHOUSE. Mr. Chairman, I will not use all of my time. I just want to thank you and the Ranking Member for hosting this important hearing. I think the idea that Senator Enzi has mentioned of a capital budget is a very important idea. The way things work around here now, something is either an important investment or wasteful spending, depending on your point of view about the merits of the underlying program. It would be great if there was some method for actually making a formal determination of what really qualified as an investment and what really was just spending, and I think a capital budget would allow us to do that. I know it is complicated, but I want to put myself on record in support of it, and I would be glad to work with any and all to try to come up with a mechanism that allows us to have a capital budget. States certainly do, municipalities certainly do, companies do. Even American families do. And I think it would make sense for us to.

I also want to align myself with all the witnesses and Senators who have spoken in favor of moving to a multi-year budgeting process. Trying to do it year by year has simply proven unsuccessful, and there is no greater sign of the deficiencies in that process than the undistinguished spectacle that we call vote-a-rama. It is an undistinguished name for an undistinguished spectacle and adds nothing to the process of serious budget development.

The last thing I will mention is that it is a mechanically difficult thing to deal with, but over and over again we face issues where you can take an existing governmental mechanism or program and you can cut it. And by cutting it you can easily get the number at the end of the day of what the savings are going to be. Very often you can also take that program and reform it and make it more efficient. There can be enormous amounts of money lost in the sort of Rube Goldberg circuitry of various programs. And we really do not have a device for trying to anticipate what those savings are or benchmark them in some way. So that means whenever we get into budget trouble, we face a huge built-in institutional bias for cutting the benefit that the American public enjoys without seriously addressing the burdensome system that bedevils them. And the bias that that creates I think is a very unfortunate one because it leads us away from the hard work of trying to make a system run more efficiently and work better, and steers us towards the easy path of taking something away from Americans that they have often paid for, are very often entitled to, and we have conceded over the years or believed over the years is a good idea for them to have. And that discussion is one that I think our budget process does very little to improve, and as the Chairman knows, because he has heard me give this speech 9 million times now, the

health care system is the ultimate example of a system where over and over again we have had witnesses before us at hearings who have over and over again focused on the cuts side of it and never been able to focus seriously on the delivery system reform piece. And they have said to this Committee, "Well, the reason we do not do that is because you cannot score it. If you could score it, we would go there."

And so what is somewhere between a $700 billion a year and $1 trillion a year savings for this country falls off the discussion, and it is probably the most important discussion we could be having, and yet it falls right off the table because it does not have a mechanism for scorability. And I think that creates a very, very significant public policy error and oversight, and I would love to find a way to try to work on that, too. That is a thornier one than just a capital budget or multi-year budgeting, though.

So I appreciate what the Chairman and the Ranking Member have done to try to call us together on this, and I will close with those thoughts. And thank you very much.

Chairman CONRAD. That is an important point. You have made it repeatedly, and you have made it well. And I personally believe it.

One thing that could be done in that second year would be a focus on issues like that one. If you are looking around for opportunities to save money for the United States, there is probably no bigger treasure trove than that one. And you need time. You need time to delve into it.

Senator Ayotte.

Senator AYOTTE. Thank you, Mr. Chairman. I want to thank the witnesses for being here today and the Chairman for holding this hearing.

I first of all want to ascribe myself with the comments of Senator Johnson. I fully agree that we need a biennial budget process, zero-based budgeting, and we should be coming up with solvency for entitlement programs for the next 75 years.

I have a question for Ms. MacGuineas. With respect to the Super Committee and the goal that has been set of $1.5 trillion, is that sufficient to stabilize our debt over the next 10 years?

Ms. MACGUINEAS. Thank you for asking that question because I think the work of the Super Committee is so incredibly important, and it is such an incredible opportunity to make real progress on these tremendous challenges. And while obviously saving $1.5 trillion would be a very large amount of savings, I think there is no question that it falls short of what we actually need to do in order to stabilize the debt.

So we have had a lot of people, a lot of outside groups, a lot of outside institutions, from the Fed to the IMF to others, who have, one, found that our debt levels are already harming our economy, so when we are thinking about how to generate economic growth, not only is how we fix the budget incredibly important on the tax and public investment side, but making sure to bring those debt levels down quickly while also allowing the economy to continue to recover is incredibly important in doing so. And we have also had a number of outside commissions that have looked at the magnitude of the savings that are necessary probably to be the bare

minimum, which is to bring the debt back down into the range of 60 to 70 percent of GDP within a decade and then closer to historical levels, which are below 40 percent.

Chairman CONRAD. Could I just stop you on that point and make the point?

Ms. MACGUINEAS. Yes.

Chairman CONRAD. You are talking there about publicly held debt.

Ms. MACGUINEAS. Yes, right. You have had testimony about two different types of debt.

Chairman CONRAD. I do not want people who are listening here to be confused. Publicly held debt is about 30 percentage points lower than our gross debt. So when she is talking 60 percent publicly held debt, that translates into about 90 percent gross debt.

Ms. MACGUINEAS. That is right, and a lot of the economic studies have looked at the gross debt, so then you have translate it into the publicly held debt.

But what we do know from these different studies about what savings it would take is that we are from a realistic baseline talking about something which is probably at a minimum $4 trillion in savings. And I think the key there is that it is something that is that big that allows us to get to a sustainable or closer to a sustainable debt level, but also allows us to tackle those critical pieces of the budget which you just brought up, in fact, the entitlement programs as well as the big tax expenditure piece of the budget.

So in no way to take away from the challenges of saving $1.5 trillion, which is real money and an important step forward, but we know we have to go bigger than that to fix the problem, and I think when you have a problem that is sitting there that has such detrimental consequences if we do not, we should do everything to save as much as possible.

Senator AYOTTE. Thank you. I just want to be clear.

I firmly believe that we need to do much more and we need to set a much bigger goal if we want to stabilize our debt. And I very much appreciate the point that you made in terms of the impact on our economy with the growth of our debt and it hurts our economic growth as well. And we all know that Americans are very concerned, rightly so, with our economic growth and wanting to have jobs right now. So I really appreciate your testimony.

I wanted to also ask you, you said something, Ms. MacGuineas, that struck me, which is you said that while we can enact budget reforms, you said, "None will replace the hard decisions that we need to make to change our fiscal situation." And what that struck me in hearing that is that, you know, it has been over 2 years since the Senate has passed a budget. If you look over the last five out of seven election cycles, we have produced no budget resolution. And so while we can change to a biennial budget process, if Congress does not do its job—you know, I am wondering if we do not pass a budget, if we are not willing to make the hard calls, it really does not matter how we reform this process. And so I have just been wondering maybe we should have a sequestration on our own pay if we do not pass a budget. Any thoughts you have there I would appreciate it, because I think you would all agree that no matter what changes we make, if we do not follow through, then

we will not put our country on a fiscally responsible path and have a fiscal path and road map going forward. Would you all agree with me on that?

[Witnesses nod.]

Thank you.

Ms. MACGUINEAS. Yes.

Senator AYOTTE. One final question. We have talked about States that have a biennial budget process. New Hampshire has one. In fact, we are going to be a State that has a surplus this year. I wanted to say without looking at the issue of a balanced budget, because almost every State in this country has a balanced budget requirement, legal requirement, I think all except one, and New Hampshire does as well. If we continue to grossly exceed—the amount of expenditures grossly exceeds revenue coming in, does it really matter in terms of what kind of budgeting process we have? Or are we going to continue to dig ourselves into a hole that we continue to add to the $14 trillion in debt?

Ms. MACGUINEAS. One of the things on this Peterson-Pew Commission that we contemplated was what position to take vis-a-vis the balanced budget, and I think one of the scary realities is just how far away we are from a situation where we could balance the budget. So we sort of removed ourselves from the current massive deficit situation and thought, once we get back into a sustainable position, what would you ideally want? And basically we concluded and recommended that balancing the budget over the business cycle is the right objective so that you allow yourself some flexibility either through building up surpluses and drawing them down, down, down during downturns. And one idea we came up with was that every President should offer a budget that balances over that 8-year term, which basically reflects the business cycle. So it would not be as stringent as the States where you have to balance on the annual basis, though, of course, because of capital budgets there is more flexibility. But to put in place that sense that if you are going to borrow a little bit at one point, you have to offset that at another point so that over time balance is your objective. I wish we were closer to that today than we currently are. What is frustrating is that past fiscal efforts we have been going towards balance, and now are trying to stabilize the debt at a level that is arguably still too high. We are so far off from that mark, it is very frightening, really.

Senator AYOTTE. Thank you.

Chairman CONRAD. I thank you.

Senator Wyden.

Senator WYDEN. Thank you, Mr. Chairman.

Ms. MACGUINEAS, let me start with you. You all have done some very good work on both spending and taxes, and I want to talk with you, before we get to some of the process issues, about the opportunity in the Super Committee to get a bipartisan agreement on the issue of revenue. I think if you do that, a lot of opportunities open up for the kind of big initiative you all are looking for.

Today, when you mention the word "revenue," a number of Republicans are certainly going to say, "This is Democrats trying to raise taxes." And then when Democrats hear that, they will say, "Well, this is Republicans in effect just sidling up to folks who are

particularly well off." And my sense is that you can get beyond this polarized argument today on revenue by looking at tax reform, because if you have growth-oriented tax reform, you can generate revenue in the private sector. That will appeal to Republicans. It helped us create 6.3 million new jobs in the 2 years after the 1986 bill. But it will also appeal to Democrats because you have a chance to go after these tax expenditures, broaden the base, and increase progressivity, increase fairness in the code.

Do you share that view that this is an opportunity to bring both sides together in the Congress and the Super Committee around revenue if we take a look at this kind of growth-oriented tax reform?

Ms. MACGUINEAS. Thank you for the question, Senator, and thank you for your leadership on putting out tax reform ideas which are really tremendous and have moved the whole discussion forward.

I absolutely do. I am in no way so politically naive as to say sort of this whole issue of revenues is going to be no problem, we know how to resolve it. But the advantage here is that we are starting with a tax system that is absolutely so awful and there are so many ways to overhaul it and improve it. And, you know, I am an "eat your spinach" kind of Pain Caucus person. I do not sell easy solutions very often. But actually because the tax system is in such disarray, we have a remarkable opportunity where we can have pro-growth tax reform—and I am not, you know, "you cannot cut taxes and grow your way out of the problem." I do not sell that kind of stuff at all. But we can reform the Tax Code by clearing out so many of these tax expenditures, lowering rates, generating growth, that it will contribute to one of the truisms about fixing the situation, which is revenues will have to be part of the solution. But they do not have to be part of the solution by hiking tax rates. We are at a point where we can do this—by the way, the same kind of model we did in 1986 and that you have put out there and that the Bowles-Simpson plan has put out there. But by broadening the base tremendously, which improves the efficiency because these $1.3 trillion in tax breaks misallocate resources more often than not, lower rates, which is pro-growth, and create significant revenues that can help close the fiscal gap.

So I do think—and you are hearing all sorts of arguments right now, well, we do not have time to get tax reform done. Well, we have a great starting place with work that you have done, with work that we have seen from Bowles-Simpson. We do have time to make tremendous progress with work that the Gang of Six has done on how to put together different steps to get to the tax reform we would need. And we know that we can put revenue targets, distributional targets, rate targets, and come up with a superior tax plan to what we have now which would solve the different priorities that both progressives and conservatives have that they can all be met in some ways with tax reform. So it is quite an opportunity.

Senator WYDEN. Let me ask you about one other question that goes to the process issue, and I think you and I touched on it a long time ago, but more people are starting to come back to it. That is, when we get real tax reform, what kind of processes could be put

in place to keep from the backsliding that took place after the 1986 bill? It seemed after 1986 practically as soon as the ink was dry on the 1986 bill, everybody came back and started larding it up with all the preferences and the goodies of one sort or another.

Now, no current Congress can ever permanently bind a future Congress, so you cannot lock something in a box and just say it is never going to be touched. But there have to be some ways to at least make it tougher to unravel tax reform, to basically have a process, for example, where you could require some votes to unravel it or something of that nature.

Have you all taken a look at that? And what would be your thoughts? I just have a few more seconds. We can discuss it another time. But what would be your thoughts on trying as part of the tax reform this time to prevent the backsliding that took place right after 1986?

Ms. MACGUINEAS. Yes, it is a great question, and you so often hear Members of Congress talking about how much they support tax reform, and then in the next breath recommending 12 new tax expenditures, because they are so fun, right? They are a tax cut that gets you something you want. Who can resist it? So the incentive to backslide is huge there.

We have actually a whole paper that recommends different ways to reform tax expenditures and keep those on track, but just one of the big ideas is tax expenditures should be treated more like spending and subject to all the budget process rules, and PAYGO for tax expenditures. Once you put in place the reform for tax expenditures, you should have basically a PAYGO where you have limited yourself to whatever you have kept in place, and that for any new one you put in there, you would have to offset it with other tax reforms.

So there are many processes, again, never place, you know, policy choices, but that can help keep that reform on track for a longer time than if you were to just put it in place and let it unravel, as it inevitably otherwise would.

Senator WYDEN. My time has expired, but I thank you and your colleagues for your good work.

Chairman CONRAD. Senator Thune.

Senator THUNE. Thank you, Mr. Chairman, and thank you all for your testimony this morning. I am glad to hear the consensus forming around biennial budgeting. I think that is a reform that is long overdue around here, and I hope that—to get away from a budget process that does not work, we need to change it. And I think that the quicker we do that, the better off we are all going to be—most importantly, the American taxpayer.

I am interested in knowing, in addition to a biennial budget, I have got a budget reform bill that has been kicking around here for a while that also calls for a joint budget resolution rather than a concurrent budget resolution where you would have buy-in from the administration more on the front end that hopefully would involve consultation with the executive branch of the Government, too. And I am wondering what your thoughts are on that and whether you believe that the administration and Congress ought to work, be forced to work more closely on a joint budget resolution and perhaps then would Congress have less flexibility to violate the

budget resolution, a joint budget resolution once it is passed. Mr. Kettl, if you want to start off.

Mr. KETTL. Senator, the idea of trying to find some way of making sure that the administration and the Congress get on the same page is an important goal. The reason why we have the process that we have now was a reaction to Watergate back in 1974, where Congress, in an effort to try to assert itself, feeling that the administration had, in fact, usurped too much of the legislative function in the budget process, created the process that we have now.

There are two concerns. One is that there is a risk of slipping back in that direction given the fact that the administration has so many strong cards to play in the budget process. That is, can Congress really establish and maintain its independent voice in the budget process? And the second is Congress' need to come up with its own voice on what it is that the budgetary process ought to be.

Clearly we need to do a far better job of bringing the administration and Congress together on the same page ultimately in the budget process. I would have some concerns about slipping back into some of the same kinds of processes that got us to the point where Congress created the Budget Act in 1974 to begin with.

Senator THUNE. Mr. Kendall.

Mr. KENDALL. I remember as a young staffer on the House side learning about the budget resolution and the President does not sign it? What? It did not make any sense. But I think the only way to evaluate whether you should have the President sign the budget resolution is whether it is going to make it harder or easier to get a budget deal. We have had so much trouble getting a budget deal that the question is whether that would make it easier or harder. And I do not think it is obvious which way because, on the one hand, making it even harder may just kind of help get all the tensions up front and deal with it up front. On the other hand, making it harder—you know, it might make it easier, you know, for other games to be played. And so it is not clear to me that there is sort of a win-win on that one. But it is certainly something that should be on the table, absolutely, and I would love to hear everyone else's comments, too.

Ms. MACGUINEAS. Again, because we have done a couple process commissions, that is something that we have looked at and we have come out supporting, thinking it would make it more difficult in some ways to get the budget done, but it would make the budget so much more meaningful. And also because I have had the chance to comment on your bill when I followed you on a panel once, I think there are so many good ideas in the bill that you have put forth.

The one thought that I recall having is that bringing tax expenditures into some of your ideas, you have sunset commissions and other things. I mean, these tax expenditures are Government spending through the Tax Code, and subjecting them to a lot of the rigor and sort of thoughtful different processes that you have recommended in your work I think would be useful. But on specifically the joint budget resolution, we are on record as having supported it even though it would be tough.

Senator THUNE. Well, I do not disagree that it would be tough. It just seems from an enforceability standpoint and to have the

buy-in of the administration earlier on in the process, that once you get that—you know, right now the President submits his budget. It is always declared dead on arrival in Congress.

Ms. MACGUINEAS. Right

Senator THUNE. Congress writes its own thing. And I think it would bind the Government of the country and inform a strong responsibility to the American people to actually do something if everybody had an ownership in it. Anyway, that is sort of my view. I just think right now we have got this bifurcated system which just does not work, frankly.

Ms. MACGUINEAS. Agreed.

Senator THUNE. You know, we have got a fiscal year—we have not passed any appropriation bills. We have got agencies that are preparing budgets without knowing what their funding is going to be. Just sort of a yes or no, and maybe a little bit of context to it, if you want to add it, but would a budget request from the executive branch be better informed if it were done on a biennial basis, do you think? Mr. Kettl.

Mr. KETTL. Senator, I do not think there is any doubt that the situation would be better. One of our biggest problems right now is that executive branch agencies are in a continual state of Never Never Land on the budget. They are, in fact, putting new budget proposals together without knowing what last year's budget even is going to be, and a set of continuing budget resolutions is only creating more inefficiency in executive operations. And an opportunity for at least a little bit more advanced planning and an opportunity to be able to make more efficient decisions in the longer haul would vastly improve the efficiency of the executive branch operations. In fact, for whatever advantage there may be, which I think are substantial, having a biennial budget from Congress' point of view, it is worth doing for the sake of improving efficiency in the executive branch for that alone.

Senator THUNE. Okay. Thank you. My time has expired, Mr. Chairman. Thank you.

Chairman CONRAD. I thank the Senator.

Senator Cardin. And let me just say that this will be the last questioning opportunity with this panel because we have a second panel and we need to get to that because we are heading into kind of time crunch land.

Senator Cardin will be the last to question this panel.

Senator CARDIN. Thank you; Mr. Chairman, and thank you for this hearing. I was listening to Senator Thune, and I was thinking back to the days that I chaired a committee with Congressman Nussle in the House looking at budget reform. We did not get very far. We had the attention of our leadership that set this committee up, but that is about as much attention as we got.

But turning the budget resolution into law was one of the issues we looked at, and we gave very serious consideration to it. We tried to get it done. We could not get the internal support within Congress because of the jurisdictional concerns of committees, which is a blood sport here, as I think many of you know, and that would also create that issue. But it is interesting. I think we have moved to that in a way. When you look at when we have had our most orderly budget deliberations, it has been after some type of a sum-

mit where the House, Senate, and President got together on some budget agreement, and most recently on the debt ceiling crisis where we were able to get a law passed that in a way codified some of the responsibilities of a budget agreement.

It is also interesting to point out that it has been reported that one of the options that the Joint Committee is looking at is to legislate a budget, have it signed off by the President, and instructing the committees to do certain work similar to what a budget resolution would require.

So it seems to me that we have de facto moved in that direction at times, and to try to now make that the budget policy of our country makes a great deal of sense, because it is not just getting the President to buy in at an earlier stage. I do not see it so much as the problems we had during Watergate where the President was usurping power. The problem we have now is that Congress by default does not really exert itself. We do not really have an orderly process. In the end we have to sort of move together to try to come up with something, and the administration could be pretty powerful in that regard under our current rules.

So if you have an orderly process where you have to come to agreement, the House and the Senate and the President, and if there are consequences for that failure—for example, there could be an expedited process after that where only emergency legislation can be considered until the budget resolution, in fact, is made part of law, which, again, would be in the early stages of a legislative year, it avoids the type of problems we have had over the last several decades. We have not had many years where we have had an orderly process on the budget.

So I am not sure I quite understand your point about, your concern about the executive power, and I would like you to comment—and maybe I should ask the second panel this. How do you overcome the institutional problems between a Budget Committee and the Appropriations Committee and the authorizing committees? How do you overcome that if we were to turn a budget resolution into a document that had the full force and effect of law?

Mr. Kettl. Senator, in the questions that you raise, there is a whole set of very important, extremely fundamental questions. The first has to do with Congress' basic prerogatives and what Congress' essential role ought to be. And the point on Watergate had to do in part with executive encroachment, but also a belief by Congress at the time that it was important for Congress to have and exercise a separate and essential fundamental voice.

There is no doubt that we have to use that no matter what to get to agreement with the executive branch, but the second concern is that many of the large summits where we have had leaders and the President locked in a room and not let them out until they come to some kind of agreement has been in the context of a crisis. And the worry would be that it might take a crisis to be able to make that happen on a regular predictive basis, and I am not sure we would want to have to try to count on recurring crises to be able to make that, in fact, occur.

Senator CARDIN. But we created those crises.

Mr. KETTL. And some of them——

Senator CARDIN. They were not external. Quite frankly, they were internal.

Mr. KETTL. I think that is absolutely right.

Senator CARDIN. Yes.

Mr. KETTL. The question is whether or not process can overcome what are essentially differences in political judgment on this. The fundamental question, I think, is the one that you raised, which is, in the long run, is this going to make it easier or harder to get the budget deal done? And I am not sure as a matter of fundamental principle, other than Congress' careful look at its prerogatives and the role that it wishes to play in the process, that other than that the most important thing is what is the most sensible way to get from where we are to a regular process of producing a predictable budgetary plan and——

Senator CARDIN. But now we operate under CRs. That certainly is not the way we should be doing it. We go deep into the fiscal year before we resolve our issues. If we had a requirement to enact a budget law by a certain date with consequences, then it seems to me you confront the—if it is going to be a crisis that we create, again, we do it at an earlier stage in the process rather than doing it and holding Government workers and recipients of Government services hostages.

Mr. KETTL. It is clear that where we are now is a series of procedural crises in addition to the fiscal one that is undermining confidence in the process. And let me just say I would be enthusiastically in favor of anything that would get us back on a more regular track, that would ensure that, in fact, the policymakers in Washington could talk to Americans about getting the work done and getting it done in a reasonable fashion.

Senator CARDIN. Thank you.

Chairman CONRAD. We are going to go to the second panel now. I just want to say before colleagues depart, Senator Begich has made a suggestion to me that I think has merit. I think we need to meet in kind of a pre-markup, members of this Committee. We have got an opportunity to do a letter by October 14th to the special committee as a Committee with respect to recommendations that we might make. I think before this week concludes—I have not had a chance to talk to Senator Sessions about this, but I think before this week concludes, we really need to get together as a Committee and discuss is there an opportunity here to move forward together and have a consensus proposal that we send to the special committee. And I do not think we can wait. If we do not have something this week, it is not going to get drafted, not going to get considered.

So I would just put members on notice that perhaps on Thursday we have a meeting, and I would do it just as the Committee, and see if there are some fundamentals that we could agree on.

With that, I want to thank this panel and indicate we deeply appreciate the contributions you have made.

We will go now to the second panel. We thank them very much for being here: Bill Hoagland, the former Republican Staff Director of the Senate Budget Committee; Marty Paone, the former Democratic Secretary of the Senate; and Eric Deland, former Chief of Staff to Senate Majority Leader Bill Frist. We could not have a

more distinguished panel, one more experienced in budgeteering than this one, completely bipartisan.

We have focused so far on the question of moving to biennial budgeting, but we also have a fundamental need, I believe, to reform the vote-a-rama process because in dealing with these issues with leadership, frankly, one of the reasons you do not get to a budget resolution, leadership does not want to go through vote-a-rama. That is just—and members do not want to go through vote-a-rama, because it has just become so disconnected from a process that people can respect.

Mr. Hoagland, welcome back to this Committee. You served here as Staff Director under Senator Domenici for many years, and succeeding Republican Chairmen. You are highly respected by the members of this Committee and by members of this body. We welcome you back.

STATEMENT OF G. WILLIAM HOAGLAND, FORMER STAFF DIRECTOR, U.S. SENATE COMMITTEE ON THE BUDGET

Mr. HOAGLAND. Thank you, Mr. Chairman, Senator Sessions, members of the Committee. Thank you for inviting me back. The only other time I was asked to testify before this Committee was on this very same subject in 2009, and I believe Senator Whitehouse and you were the only two here, so if you wish to leave, I am pretty much going to say the same thing I said 2 years ago.

And I also feel a little bit out of place here with the two real ex-Senate floor experts in Marty and Eric, but I will try to summarize real quickly my testimony and ask that the full statement be entered in the record.

There were three issues then, 2 years ago, that continue today, and that is, vote-a-rama has and always will create a great deal of angst and frustration and exhaustion for Committee and floor staff. But I think this is an inconvenience that is acceptable to the staff as our responsibility to you as floor managers to help bring the resolution to completion. And despite the frustration and the practice over the many years, budget resolutions and reconciliation bills always do come to a conclusion.

Second, though, and probably infinitely more important today is the feeling that the procedure has helped contribute to the diminished public respect for this institution over the years. The public watching on C–SPAN does not understand the intricacies of the Senate rules, but they do understand confusion, frustration, and seemingly endless votes on measures that have not been debated fully. And, worse, I am afraid, the spectacle of this process has bolstered opponents of the congressional budget process and provided the fodder to them to argue for the elimination of the process rather than what we should be doing as reforming the process.

Third and critically—and you mentioned this in your opening statement—the rights of the minority have to be protected. The budget resolution and reconciliation bill are the only Senate vehicles with a guaranteed right for any Senator to offer an amendment and receive a vote. Rightly or wrongly, vote-a-rama does ensure that not only the minority but any Senator can offer amendments. Otherwise, it would be possible for the majority to continu-

ously yield time off the resolution and other procedures and basically block out the minority.

This is a debate and a delicate balancing act required here between not just the issue of accommodating individual Senators but also to accommodate the Senate itself.

In my 2009 when I testified before you, I tried to go through the history on this process. In the interest of time I will not do that again here, except to once again note that when this budget resolution bill or the Congressional Budget Act was reported by the Senate Committee on Governmental Operations in 1973, they allocated 100 hours to the consideration of a budget resolution. And today, after a little closer examination of what else was going on in the Senate at that time, I now think that may have also informed the drafters of the Budget Act at that time.

Cloture became more frequent in the 1970s, but Senator James Allen perfected the "post-cloture filibuster" that did not limit the number of amendments that could be filed, read, voted on, thus resulting in no limit on time consumed. So we really have the first real form of vote-a-rama on a clotured bill, and it was Senator Byrd who successfully proposed changing Rule XXII at that time in 1979 to control that post-cloture filibuster by setting an overall 100-hour time limit for consideration of amendments post cloture and a filing of amendments in a first and second degree order. And that same 100-hour time limit set by the drafters of the Budget Act 6 years earlier but maybe because the Senator Allen's post-cloture filibuster had not fully developed at that time, maybe the drafters of the Budget Act did not distinguish between debate time and full consideration time.

I conclude today, as I did 2 years ago, that the legislative history never envisioned vote-a-rama simply because it was assumed that there would be sufficient time and adequate time available for the full consideration. I realize that arguing additional time for a resolution or a reconciliation bill runs counter to the current demands placed on Senators and any Majority Leader trying to run the floor schedule. So what is the alternative?

Since the late 1990s proposals to find a procedure allowing for greater transparency of amendments offered within time constraints has been the direction we have gone.

I point out to you that in 1997, with Republicans in the majority, the Senate did adopt by a vote of 92–8 an amendment offered by Senator Byrd that modified debate on reconciliation bills. It increased the statutory time for consideration, set a time period for the filing of first and second degree amendments, and added in the statute Senate Rule XXII language that brought to a close all action on reconciliation bills after 30 hours.

Mr. Chairman, you and Senator Sessions voted in support of the Byrd amendment as did former Chairmen Hollings, Domenici, Nickles, and Gregg and former Ranking Member Senator Lautenberg. And every member of the Senate at that time that serves now on the Senate Budget Committee today voted for that amendment—Senators Grassley, Murray, Enzi, and Wyden.

Unfortunately——

Senator SESSIONS. Again, what was the effect of that?

Mr. HOAGLAND. It was to take the reconciliation bill, which I think at that time was 25 hours or 20 hours at that time, and move it up to 30 hours. It then required that there be a filing of first degree and second degree amendments within that 30-hour time frame, and it put in place that shut-off of full consideration done after 30 hours. You are finished. No vote-a-rama.

Senator SESSIONS. But if you filed your amendment, you got your vote?

Mr. HOAGLAND. You got your vote within—yes. If you filed it within the time frames that Senator Byrd had specified. It was dropped in conference. It was on the 1997 reconciliation bill, the Balanced Budget Act.

So what is to be done today? I think the Senate needs to rethink, first of all, what its goals are in having a budget resolution and in considering a budget resolution. If the Senate wants to limit all time for consideration, there is one simple accomplishment that can be accomplished through imposition of a post-cloture type rule.

Alternatively, if the purpose of the budget resolution is to provide an opportunity for the Senate to engage in a more orderly debate surrounding fiscal policy while protecting the rights of the minority, then, I think, Mr. Chairman, the things that you have outlined at the outset are the same kinds of things that I would argue today. I would require one minimum layover of a resolution. Just in fairness, I would also suggest that that rule also maybe be applied here within the Committee so that if the majority—if the Chairman or the Ranking Member have a caucus proposal, that that be laid over one day before the Committee considers it; require unanimous consent on yielding back of time; if 50 hours is the statutory time limit, limit to two amendments per Senator and require that they alternate, as I think we do today; and adopt a statute that has a clear definition of germaneness that would prohibit the consideration of Sense of the Senate amendments. I thought this had been resolved, but I understand the practice continues today through the Senate Parliamentarian's office rulings. I do not criticize the Parliamentarian's office. I just simply think that they need a find-tuned definition of germaneness, and it is not really their responsibility to have that kind of power.

I would also expand—and you may find this not comfortable. I would expand the definition of this to eliminate deficit-neutral reserve funds which have, I think, proliferated in part as a way around the germaneness test. And I guess I would once again argue to do away with Function 920 in the reported budget resolution, or if they are technically needed, allow for the reporting of a budget resolution with the function but make it out of order on the floor to offer amendments that touch Function 920.

And, finally, I believe that while increased vote-a-rama activity is a function of many variables, one of those variables is whether the resolution is considered in even-numbered years or odd-numbered years. Too many times I was aware of amendments drafted on both sides of the aisle to stoke political press releases, some I probably had a hand in, and it was understood that the political campaigns considered budget resolutions the mother lode of opportunities for political ads. I have no foolproof suggestions on how to deal with the "gotcha" amendments, unless it would be to establish

a biennial budget and appropriation process with the budget resolution considered in the odd-numbered year.

Thank you for the opportunity to return to the Committee and testify before you this morning. Thank you.

[The prepared statement of Mr. Hoagland follows:]

Senate Procedures for Consideration of the Budget Resolution/Reconciliation "Vote-A-Rama"

Testimony before the Committee on the Budget, U.S. Senate
October 4, 2011
G. William Hoagland[1]

Mr. Chairman, Senator Sessions and members of the Committee, I appear before you once again to discuss the Senate practice that has become unflatteringly known by the term "vote-a-rama." The only other time I was asked to return to this my favorite Senate Committee and testify was on this same subject in 2009.

In fairness, except for the fact that there has been only one full budget resolution debated in the U.S. Senate since that testimony, you will not be surprised to find that my comments on this subject have not changed significantly over the last two years.

Three issues then continue to remain true today.

First -- vote-a-rama – has and always will create much angst, frustration, and exhaustion for both Committee and floor staff. Back to back votes, limited time to review and debate, and uncertainty on what Senators are voting on are the hall mark of vote-a-ramas. This is true whether at the end of a budget resolution's 50 hours of debate or a reconciliation bill's 20 hours of debate.

The inconvenience visited upon staff from this practice, I believed then as I do now, is acceptable as staff's responsibility to the floor managers to help complete the measure. Unlike many bills that come before the Senate and could be postponed to a later date or even next session of Congress when cloture has not been invoked, budget resolutions and reconciliation bills are time sensitive and must be disposed of one way or the other. And despite the growing practice and frustration engendered by vote-a-ramas, budget resolutions and reconciliation bills have always been brought to completion.

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[1] 1 Staff of the Congressional Budget Office 1975 to 1981. Staff to the U.S. Senate Budget Committee, 1982to 2002. Staff to the U.S. Senate Majority Leader 2003-2007. Currently Vice President for Federal Affairs, CIGNA Corporation.

Second, an infinitely more important issue today when the Congress is given such low public ratings, is the feeling that this procedure somehow has helped contribute to diminished public respect for this institution over the years. The public watching on C-Span does not understand the intricacies of Senate rules, but they do understand confusion, frustration and seemingly endless votes on measures whose merits or demerits have not been fully debated. Worse, the spectacle of a vote-a-rama has bolstered opponents of the congressional budget process – and provided fodder for eliminating the process completely when what is called for is in fact a strengthened and reformed process particularly in these difficult fiscal and economic times.

Third and critically, the rights of the minority have to be protected in this process. The budget resolution and reconciliation bill are the only Senate vehicles with a guaranteed right for any Senator to offer an amendment and receive a vote. Rightly or wrongly, vote-a-rama does ensure that not only the minority but any Senator can offer amendments. Otherwise, it would be possible for the majority to continuously yield time off the resolution to prolong debate on only a handful of amendments until time had expired, fill the tree and lock out amendments until time had expired, or yield back time to consume portions of the hour limit so that amendments could not be offered under the cap. All three practices – yielding time to limit amendments, filling the tree, and yielding the majority's share of time – have been used to varying degrees over the years to weaken minority rights.

But this is a delicate balancing act that must not just accommodate an individual Senator but also accommodate the Senate itself.

There may be a better, more orderly, and fairer way to complete action on these vehicles.

In my 2009 testimony I tried to determine how this process might have come about from the legislative history of the Congressional Budget and Impoundment Act. In the interest of time I will not repeat that analysis except to observe that the history would suggest that the authors of the original Senate bill in 1973 -- Senators Ervin, Metcalf, Percy, Nunn, Brock, and Cranston -- included language on procedures for consideration of the "budget limitation bill" that is almost identical to the language found today in Section 305 (b)(1) of the final Act. When the bill was reported from the Senate Committee on Government Operations 100 hours of debate were allowed on the budget resolution.

The Senate drafters were clear and explicit that the budget resolution was to be treated as a highly privileged matter and those 100 hours was to give assurances that both Houses of the Congress had adequate time for the full consideration of the budget.

The one addition to my 2009 testimony I would add today is that on closer examination of what else was going on in the Senate at that time may have informed the drafters of the Budget Act.

Cloture became more frequent in the 1970s, but Senator James Allen (D-AL) perfected the "post-cloture filibuster" that did not limit the number of amendments that could be filed, read, time in quorum calls, roll call votes or even how much time could be consumed overall.[2] The first real form of a vote-a-rama on a clotured bill.

It was Senator Byrd in 1979 who successfully proposed changing Rule XXII to control the post-cloture filibuster by setting an overall 100 hour time limit for consideration post-cloture and a filing requirement on first and second degree amendments. Obviously the same 100 hour time limit as was set by the drafters of the Budget Act six years earlier but maybe because the Senator Allen's post-cloture filibuster had not fully developed in 1973, the drafters of the Budget Act did not distinguish between debate time and full consideration time.

I conclude today as I did two years ago that the legislative history never envisioned "vote-a-rama" simply because it was assumed that there would be sufficient and adequate time available for the full consideration of the resolution both before the resolution was presented to the Chamber and within the established statutory time constraints. Further that the strict requirement that amendments offered to the resolution must be germane[3] would also be a limiting factor.

But this was not to be the case particularly beginning toward the latter part of the 1990's when the number of amendments to resolutions exploded. For the first 20 years of the Budget Act the average number of amendments offered yearly to a resolution was 21. The next 12 years the number averaged nearly 80, reaching a peak of 113 in 2008, and as the Congressional Research

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[2] Martin B. Gold, Senate Procedure and Practice, Rowman &Littlefield Publishers, Inc. 2004.

[3] Section 305 ©, (4): Germaneness: prohibits the consideration of non-germane amendments to budget resolution and by cross reference to Section 310 (e), to reconciliation legislation. An amendment is per se germane: (1) changes numbers, (2) motion to strike, (3) changes dates. Other amendments are determined on a case by case basis by the Parliamentarian.

Service has analyzed – 60 percent of those votes in 2008 occurred after all time had run out on the 50 hours.

I will give the benefit of the doubt to the motives of Senators and their staffs drafting amendments to these vehicles. One can argue that vote-a-rama is not intentionally meant to be a delaying or dilatory tactic or wanton revanchism for after all a final vote will eventually happen if for no other reason than out of exhaustion. Rather, one might argue that Senators must feel that the full consideration of such an important blue-print to guide fiscal policy has not been achieved within the 50 hours of time available. Arguing for additional time, 100 hours as an example on a resolution or reconciliation bill runs counter to the current demands placed on Senators and any Majority Leader trying to schedule floor consider or other legislation. Further, expanding time would place tremendous pressure on the managers of the resolution to secure Senators' participation throughout the period and not, as the members are wont to today, wait until the end of the time period to offer amendments.

So what is the alternative to increasing the statutory time for consideration?

Since the late 1990's proposals to find a procedure allowing for greater review, study, and transparency of amendments offered within time constraints has been the direction most reform proposals have taken.

In 1997, with Republicans in the majority, the Senate did adopt by a vote of 92-8 an amendment offered by Senator Byrd that modified debate on a reconciliation bill that did: (1) increase the statutory time on reconciliation to 30 hours (from 25 hours), (2) set a time period for the filing of first degree amendments within the first 15 hours and second degrees within the first 20 hours, but most importantly (3) adding in statute Senate Rule XXII language that brought to a close all action on a reconciliation bill at the end of the 30 hours. Effectively a scaled down version of his successful 1979 changes to Rule XXII post-cloture filibuster.

I would note that you, Mr. Chairman and you Senator Sessions, voted in support of the Byrd amendment as did former Chairmen Hollings, Domenici, Nickles, and Gregg and former Ranking Member Senator Lautenberg. And every member of the U.S. at that time that serves on the Senate Budget Committee today voted for that amendment – Senator Grassley, Senator Murray (obviously the Co-Chair of the Joint Select Committee), Senator Enzi, and Senator Wyden.

Unfortunately the amendment added to the Revenue Reconciliation Act of 1997 died in conference. As you will recall that bill was a major component of the balanced budget agreement reached that year, and bipartisanship could not be found in conference on the Byrd amendment so it was dropped, which quite frankly made no sense to me since it was a Senate procedure not directly impacting the House.

Following the explosion of amendments offered to the budget resolution in 1998, Senator Domenici directed me to again work with Senator Byrd's staff and others to address the issue. S.Res.6 was introduced in January 1999 and among other things limited debate on resolutions and reconciliation bills to 30 hours, specified filing deadlines for amendments. No action was taken on S.Res.6.

In 2006, Chairman Gregg introduced reform legislation that maintained the 50 hours but eliminated vote-a-rama by limiting time to "consideration" rather than "debate" the post-cloture-rule.

Senator Specter's proposal in 2008 and later in 2009 in many ways returned to that which the Senate adopted on a voice vote in 2001 but which was subsequently dropped in conference --a 50 hour time limit, first degree amendments to be filed in the first 10 hours, second degrees in the first 20 hours, and one calendar day time-out for review of all amendments printed in the Congressional Record before voting. It did not, however, eliminate the possibility of extended voting well beyond the statutory 50 hours; only a post-cloture rule would accomplish that objective.

So what should or should not be done? The Senate, indeed the Congress, needs to rethink and decide what its goals are in considering a budget resolution. If the Senate wants to limit all time for consideration of a budget resolution or reconciliation bill to a specified time while accomplishing the goals of this instrument, then there is one sure way to accomplish that through the imposition of a post-cloture rule. However, the risks remain high that such an approach would preclude the minority from offering amendments if the time limit is not expanded to more than the 50 hours today.

Alternatively, if the purpose of the budget resolution is to provide an opportunity for the Senate to engage in a logical, fully informed debate surrounding fiscal policy while protecting the rights of the minority to express their views, then the reform proposals that have been evolving since 2001 -- setting deadlines for submitting amendments early within the time period -- seems appropriate. The risk of this approach, however, means that many amendments could still be filed requiring votes beyond a 50 or 30 hour time limit, and vote-a-rama continues. The benefit, however, the Senate would have a better, informed debate and avoid some of the pandemonium present in the current process.

However the Senate chooses to address this issue, there are a few recommendations updated from my 2009 testimony I would offer today:

1. Require at a minimum 1 day lay-over of the reported resolution or reconciliation bill before proceeding to the Senate floor. Similarly, I respectfully suggest that the rules here in the Committee allow also for a 1-day lay-over when the Chairman or Ranking Member offers their caucus' mark on the budget.

2. Require unanimous consent to yield back time on a budget resolution or reconciliation bill.

3. If 50 hours is the statutory time limit, limit to two amendments per Senator and require (as is the practice today) to alternate amendments but begin with the minority having the right of refusal on the first amendment and require first degree and second degree amendments to be filed within a defined time period of the overall 50 hours.

4. Adopt in statute a clear definition of germaneness that would prohibit the consideration of Sense of the Senate amendments both during the consideration of budget resolutions and reconciliation bills. I thought this had been resolved, but I understand the practice continues today through revised interpretations from the Senate Parliamentarian's office. This is not a criticism of that office and I realize it is easier said than done to define germaneness. I simply believe that without statutory guidance the Senate Parliamentarians must use their discretion in interpreting amendments, a power that I do not believe should be bestowed on that office.

I would also expand this prohibition to "deficit neutral reserve funds" which have proliferated in part as a way around the germaneness test. Former Senator Specter's proposal to not allow

provisions contained in a budget resolution that included programmatic detail might be a way to limit reserve funds.

5. Falling in the category of "green-eye shade" issues: either due away with Function 920 (Allowances) in the reported budget resolution, or if technically needed, allow for the reporting of a budget resolution with the function but make it out of order to offer an amendment that touches the function on the Senate floor. Function 920 has become the magic asterisk for offsets to often frivolous spending amendments in other functions.

One last observation -- I believe that while increased vote-a-rama activity is a function of many variables, one of those variables is whether the resolution is considered in an even versus an odd numbered year. Too many times I was aware of amendments drafted on both sides of the aisle to stoke political press releases, some I probably had a hand in, and it was unspoken, but generally understood, that political campaigns considered budget resolutions the mother load of opportunities for political ads. I have no full proof suggestions to how to deal with the "gotcha" amendments; unless it would be to establish a biennial budget and appropriation process with the budget resolution considered in the odd-numbered year.

Thank you for the opportunity to return and testify before the Committee where I spent so many hours of my career. I still believe the Committee has a major role in helping to direct sound and reasonable fiscal policy and that reforms to the process can enhance that role going forward to the benefit of the country.

Chairman CONRAD. Thank you for your really excellent counsel. Marty Paone, welcome.

STATEMENT OF MARTIN PAONE, FORMER DEMOCRATIC SECRETARY, U.S. SENATE, AND EXECUTIVE VICE PRESIDENT, PRIME POLICY GROUP

Mr. PAONE. Thank you. Mr. Chairman, Senator Sessions, and members of the Committee, I am honored to be appearing here with Bill Hoagland and Eric Deland discussing the Senate's Budget floor procedures.

I understand that today you would like to discuss the procedure for the disposition of amendments to budget related vehicles known as the "vote-a-rama." It is a process which elicits universal reactions of groans and derision from those who have had to endure it.

When the Congressional Budget and Impoundment Control Act of 1974 was enacted, it established the much-needed linkage between the Government's spending and revenue activities. It created the House and Senate Budget Committees and established the procedures for the consideration of budget resolutions. As you know, it now limits debate time for the consideration of a budget to 50 hours; for a possible second budget resolution there is a 15-hour limit, and for reconciliation it is a 20-hour time limit.

These limits for debate on the budget vehicles include, as the statute says, "all amendments thereto and debatable motions," et cetera. It was crafted at a time when the Senate was a far different place than it is today. It is my belief that the authors of this act may well have considered their debate limitation as sufficient enough to bring about an orderly end to the budget's consideration.

They did not have the example, as Bill mentioned, of finality as embodied in cloture's Rule XXII because it did not yet exist. At that time there existed a huge loophole in the cloture rule since it did not count the time spent on quorum calls, the reading of amendments, and the voting on amendments. In those days cloture only provided for a limit of 1 hour for debate per Senator. There was no overall cap. Senators would file literally hundreds of amendments to carry on a post-cloture filibuster. The natural gas filibuster in 1977 went a painful 13 days after cloture was invoked. It helped enable Senator Byrd in 1979 to convince the Senate to adopt rules changes which brought much-needed finality to the cloture process. Except for later lowering the time from 100 to 30 hours, the 1979 reforms reflect the cloture process that exists today.

While the authors of the Budget Act may have thought they had established an orderly procedure for floor consideration, it did not take long for smart Senators and staff to realize the loophole the act afforded them. In June of 1981, there was a series of 15 votes on that year's reconciliation bill, and that was followed the next year in May of 1982 with a series of 17 votes on the budget resolution. The template was set for future vote-a-ramas.

Technically, those amendment votes, at the conclusion of the debate time, are supposed to occur with no debate, but in return for an agreement to reduce the time on the votes to 10 minutes, there evolved the permission for either 2 minutes or 1 minute, depending on the year, for debate prior to the vote. This came about because

one year we refused to agree to reduce the time for the votes without that limited debate time, the logic being that without the short explanatory time prior to the vote, Senators would need the full vote time to educate their colleagues as to the merits of their amendment.

Repeated votes on never before seen or filed amendments, with practically no debate, does a disservice to the Senate's stature as a deliberative body. Any type of reform is going to limit Senators' current rights to amend; this effects the minority to a greater extent since it is the majority that writes the budget. Any such reform should take this into account and lean towards the minority's ability to amend.

Having said that, it should be remembered that the Budget Act was intentionally written so that the majority could express its will without fear of filibuster. Its authors specifically wrote in these debate limitations in order to deny the minority the ability to derail difficult fiscal decisions. Since the impact of reconciliation spending and/or revenue bills can cut across the geographic and economic spectrum, the authors naturally expected that the opposition could well be bipartisan in nature.

There are many suggested solutions to this problem. Senators Byrd and Specter, my fellow panelists Bill and Eric, former parliamentarian Bob Dove, and others have all suggested worthwhile changes. Some that I think are most useful include the following:

Require the resolution or bill to be available for 48 hours prior to beginning its consideration;

No yielding back of time without unanimous consent;

Increasing the time for a reconciliation bill to 50 hours to mirror the budget;

End the amendment process when the debate time has elapsed similar to the current cloture requirement but with the exception of not counting the time consumed by roll call votes. Not counting vote time would ensure the consideration of more amendments;

Reducing the time on amendments to 1 hour for first degrees and 30 minutes on second degrees;

Limit the yielding of time from the resolution or bill during the consideration of an amendment to no more than 30 minutes per side for first degree amendments and 15 minutes per side for second degree amendments;

Permit the minority to offer the first three first degree amendments, thereafter alternating of first degree amendments per side; should one side not have an amendment ready to offer, it revert back to the other side at the expiration of 30 minutes of resolution or bill time. To ensure further minority protection, I would also alternated second degree amendments;

Require the filing of amendments, first degree amendments by the 15th hour of consideration and second degree amendments by the 25th hour;

Limit the managers' opening statements to 90 minutes each and specify that the opening 4 hours for debate on economic goals and policies does not bar the offering of amendments.

Some have suggested only modifying the vote-a-rama by establishing a set number of amendments per side. If that is combined with the filing stipulation, that might be a way to proceed. But

then the leadership on both sides will have the unenviable task of deciding who gets to be included in that limited list. This would not be my preferred way to go.

Much has changed in the Senate since the Budget Act was enacted: cell phones, the Internet, 24-hour cable news, BlackBerrys, computer tablets, et cetera. No longer do you have a Senate where new members learn from their colleagues the location of the best neighborhoods in which to live and raise their children. Senators getting to know each other by attending their children's school activities, by commuting together and spending weekends together at backyard barbecues are but echoes of a distant Camelot. The partisan divides are sharper now, so any reform will be difficult. But if it is attempted, it should be viewed by the majority through the lens of the minority, since eventually they too will have to live with the outcome.

If it is not possible to reform this vote-a-rama, it may be possible to limit its attractiveness.

One of the changes in the Senate that contributes to the desire by members from both sides of the aisle to participate in vote-a-ramas is the lack of a day-to-day open amendment process. To me one of the true beauties of the Senate lies in its lack of germaneness restrictions in the amending process. If you are not trying to add a tax amendment to a Senate bill, or dealing with an appropriations bill, or a statutorily established vehicle like the budget resolution or a trade agreement, there are no limits to the ability to amend. You could start out the day on a farm bill and finish it debating the Middle East peace process.

Over the last 30 years there has been increasing pressure brought to bear on the leaders of both parties to protect their members from having to cast difficult votes. As a result the amendment process has been scaled back to the point where a bill considered without the amendment tree being filled is a rarity. This is resented by those denied the ability to offer amendments, and not just by those in the minority.

So when a budget resolution or reconciliation bill comes along, even though it has a built-in germaneness restriction, members are eager to take advantage of this opportunity. Returning to a more open amendment process with all the possible nasty political votes is a better alternative. Difficult political amendment votes are not new. There have always been some on both sides of the aisle who have been eager to offer them. But while you cannot legislate good behavior, an open amendment process will be more productive and will relieve some of the pent-up pressure so that when a budget vehicle is considered the vote-a-rama will lose some of its attractiveness.

Thank you again for the privilege of appearing before you today.

[The prepared statement of Mr. Paone follows:]

Testimony of

Martin Paone

Executive Vice President Prime Policy Group

Senate Democratic Secretary 1995-2008

Submitted to the

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Improving the Budget Process: Strategies for More Effective

Congressional Budgeting

October 4, 2011

Mr. Chairman, Senator Sessions and members of the Committee,

I'm honored to be appearing here with Bill Hoagland and Eric Ueland discussing the Senate's Budget floor procedures.

I understand that today you'd like to discuss the procedure for the disposition of amendments to Budget related vehicles when all debate time has expired. This has become known by the term the floor staff dubbed the "vote-a-rama". It is a process which elicits universal reactions of groans and derision from those who have had to endure it.

When the Congressional Budget and Impoundment Control Act of 1974 was enacted it established the much needed linkage between the Federal government's spending and revenue activities. It created the House and Senate Budget Committees and established the Senate's procedures for the consideration of Budget Resolutions and Reconciliation bills. As you know it limits debate time for the consideration of a Budget resolution to 50 hours, for a

possible second Budget Resolution there is a 15 hour limit and for Reconciliation bills it is a 20 hour limit.

These limits are for debate on the Budget vehicle including as the statute says, "all amendments thereto and debatable motions and appeals in connection therewith". It was crafted at a time when the Senate was a far different place then it is today. It is my belief that the authors of this act may well have considered their debate limitation as sufficient enough to bring about an orderly end to the Budget's consideration.

They did not have the example of finality as embodied in Cloture's Rule XXII because it did not yet exist. At that time there existed a huge loophole in the cloture rule since it did not count the time spent on quorum calls, the reading of amendments and the voting on amendments. In those days cloture only provided for a limit of one hour for debate per senator-- there was no overall cap. Senators would file literally hundreds of amendments to carry on a post cloture filibuster. The Natural Gas filibuster in 1977 went a painful 13 days after cloture was invoked. It helped enable Senator Byrd in 1979 to convince the Senate to adopt rules changes which brought much needed finality to the cloture process. Except for later lowering the time from 100 to 30 hours the 1979 reforms reflect the cloture process that exists today. As you know when the time has elapsed the rule requires that the "Senate shall proceed, without any further debate on any question, to vote on the final disposition thereof to the exclusion of all amendments not then actually pending before the Senate at that time..."

While the authors of the Budget Act may have thought they had established an orderly procedure for floor consideration it didn't take long for smart senators and staff to realize the loophole the Act afforded them. In June 1981 there was a series of 15 votes on that year's Reconciliation bill and that was followed the next year in May 1982 with a series of 17 amendment votes on the Budget Resolution. The template was set for future "vote-a-ramas".

Technically these amendment votes, at the conclusion of the debate time, are supposed to occur with no debate but in return for an agreement to reduce the time on the votes to 10 minutes there evolved the permission for either two minutes or one minute, depending on the year, for debate prior to the vote. This came about because one year we refused to agree to reduce the time for the votes without that limited debate time, the logic being that without the short explanatory time prior to the vote senators would need the full vote time to educate their colleagues as to the merits of their amendment.

Repeated votes on never before seen or filed amendments, with practically no debate, does a disservice to the Senate's stature as a deliberative body. Any type of reform is going to limit senators' current rights to amend, this effects the minority to a greater extent since it is the majority that writes the Budget. Any such reform should take this into account and lean towards the minority's ability to amend. Having said that, it should be remembered that the Budget Act was intentionally written so that the majority could express its will without fear of filibuster. Its authors specifically wrote in these debate limitations in order to deny the minority the ability to derail difficult fiscal decisions. Since the impact of reconciliation spending and/or revenue bills can cut across the geographic and economic spectrum the authors naturally expected that the opposition could well be bipartisan in nature.

There are many suggested solutions to this problem. Senators Byrd and Specter, my fellow panelists Bill Hoagland and Eric Ueland, former parliamentarian Bob Dove and others have all suggested worthwhile changes. Some that I think are most useful include the following:

--Require the Resolution or Bill to be available for 48 hours prior to beginning it's consideration.

--No yielding back of resolution or bill time without unanimous consent.

--Increasing the time for a Reconciliation bill to 50 hours.

-- Ending the amendment process when the debate time has elapsed similar to the current cloture requirement but with the exception of not counting the time consumed by roll call votes. Not counting vote time would ensure the consideration of more amendments.

--Reducing the time on amendments to one hour for first degrees and 30 minutes on second degrees.

--Limiting the yielding of time from the resolution or bill during the consideration of an amendment to no more than 30 minutes per side for first degree amendments and 15 minutes per side for second degree amendments.

--Permit the minority to offer the first 3 first degree amendments thereafter alternating of first degree amendments per side, should one side not have an amendment ready to offer it revert to the other side at the expiration of 30 minutes of resolution/bill time.

--Requiring the filing of amendments, first degree amendments by the 15th hour of consideration and second degree amendments by the 25th hour.

--Limit the managers opening statements to 90 minutes each and specify that the opening 4 hours for debate on economic goals and policies does not bar the offering of amendments.

Some have suggested only modifying the vote-a-rama by establishing a set number of amendments per side. If that is combined with the filing stipulation that might also be a way to proceed. But then the leadership on both sides will have the unenviable task of deciding who gets to be included in that limited list. This would not be my preferred way to go.

Much has changed in the Senate since the Budget Act was enacted, cell phones, the internet, 24 hour cable news, blackberries, computer tablets, etc. No longer

do you have a Senate where new members learn from their colleagues the location of the best neighborhoods in which to live and raise their children. Senators getting to know each other by attending their children's school activities, by commuting together and spending weekends together at backyard barbeques are but echoes of a distant Camelot. The partisan divides are sharper now so any reform will be difficult but if it is attempted it should be viewed by the majority through the lens of the minority, since eventually they too will have to live with the outcome.

If it is not possible to reform this vote-a-rama process than it may still be possible to limit its attractiveness.

One of the changes in the Senate that contributes to the desire by members from both sides of the aisle to participate in the vote-a-rama is the lack of a day to day open amendment process. To me one of the true beauties of the Senate lies in its lack of germaneness restrictions in the amending process. If you are not trying to add a tax amendment to a senate bill, dealing with an appropriations bill, or a statutorily established vehicle like the Budget Resolution or a Trade Agreement, there are no limits to the ability to amend. You could start out the day on a Farm bill and finish it debating the Middle East peace process.

Over the last 30 years there has been increasing pressure brought to bear on the leaders of both parties to "protect" their members from having to cast difficult votes. As a result the amendment process has been scaled back to the point where a bill considered without the amendment tree being filled is a rarity. This is resented by those denied the ability to offer amendments, and not just by those in the minority.

So when a Budget Resolution or Reconciliation bill comes along even though it has a built in germaneness restriction, members are eager to take advantage of this opportunity. Returning to a more open amendment process with all the possible nasty political votes is a better alternative. Difficult political amendment votes are not new, there have always been some on both sides of the aisle who have been eager to offer them. But while you can't legislate good behavior an open amendment process will be more productive and will relieve some of the pent up

amendment pressure so that when a Budget vehicle is considered the vote-a-rama will lose some of its attractiveness.

Thank you again for the privilege of appearing before you today.

Chairman CONRAD. Thank you. Really excellent testimony.

We will go to Mr. Ueland next. Thank you so much for being here. Please proceed.

STATEMENT OF ERIC UELAND, FORMER CHIEF OF STAFF, U.S. SENATE MAJORITY LEADER BILL FRIST

Mr. UELAND. Thank you very much, Mr. Chairman, Senator Sessions. Thank you both for the invitation to speak briefly and answer questions on vote-a-rama, the Senate's practice of expedited voting at the end of budget resolution consideration. As a former senior member of the Senate used to advise his colleagues, "Be bold, be brief, and be gone." I will be careful about the first one, but I will try to live up to the second one so you all can live out the third one here this morning.

I have thought a lot about the criticisms of expedited voting, as well as some of the ideas for changes that I have heard over the years and read in previous testimony. This triggered just a few questions which frame my testimony this morning.

First, do the proposed changes affect the ability of Senators to act on their responsibilities or risk curtailing if not eliminating senatorial rights? Senators do reflect many different roles, and multiple influences guide a Senator as she decides how to vote. Both the resolution and amendments offered to the resolution reflect any of the multiple roles that Senators hold, and clearly one of a Senator's roles is political. But as former Republican Leader Trent Lott used to say, "Good policy is good politics." Taking steps that could appear to restrict Senators from offering amendments just because of concerns over their political nature seems to go too far.

Further, over the past decades, Congress has passed multiple laws which restrict or eliminate Senators' rights to amend, just like the Budget Act. But at least under the act, a Senator can seek a vote. This supermajority requirement does crowd minority rights, but is more than Senators are allowed in other procedural circumstances. To the extent that reforms to expedited voting could erode the rights of any minority under the checks and balances included in the act, that runs the risk of another law which makes the Senate look more like the House, which no one enjoys.

A second question this morning: Is there value to the current system? I think yes. Watching different leadership teams manage ever more complicated resolutions, they repeatedly run up against the reality that there just is not enough debate time to handle all the topics covered by the resolution. Within debatable time, a majority often wants to cure, modify, amplify, or highlight key matters through debates and votes.

Conversely, a minority often has more amendments than it can handle during its debate time. The expedited voting process creates appropriate options for leaders and Senators to cooperate on what to emphasize and when.

Third, what are some implications of any new process? Some changes about expedited voting could include: a filing deadline; shortening the allowed debate time for amendments; or even limiting the number of amendments a member could file or offer. A few implications for those ideas come to mind.

For example, while there is value in Senators having the chance to see all the amendments before voting begins, it is also possible a filing deadline could lock Senators being able to address new matter added to the resolution by amendments on the list or take care of a matter deleted from the resolution by amendments on the list.

On a practical matter for the Committee itself, a majority needs the ability to send to the House all that can pass legal parliamentary muster in the Senate once a conference report or privileged message returns. Due to this, in the end the finite list might end up not being so finite, after all.

In cloakrooms and on staff benches, some have talked about limiting the amendments a Senator could offer to a resolution. But preventing Senators from offering expedited voting here may just export their amendments and votes to other bills and other weeks throughout the year.

Since this is the Budget Committee, I have focused just on the resolution itself, but the act also covers many essential elements of reconciliation. Just one reconciliation bill can create, delete, expand, shrink, or alter trillions of dollars of Federal expenditures and taxes. Reconciliation debate time is so short and its rules are equally as complex as those around the budget resolution itself, that making it harder to amend reconciliation should require a lot of additional thinking by the Committee before any statutory changes are made.

Finally this morning, are there other ways to handle the concerns of Senators? The current expedited voting process is the distilled essence of the Senate at work. Hard efforts, blending multiple Senator interests, always ends expedited voting. If there continue to be complaints about the expedited voting process, I would recommend using a cooperative model to review reform ideas, similar to what was successfully done on holds, before any statutory changes are made. In that vein, there are many things that the Committee could try before turning to changes in the statute.

For example, a majority could right now simply create more time for review of the Committee mark before Committee action begins and allow much more time between the reporting out of the resolution and commencing action out on the Senate floor. This could allow for a clearer understanding of the resolution's contents and reduce the pressure to act and counteract which plays out during markups and out on the floor during consideration.

In the intervening period between reporting and starting action, an annual presentation by Committee counsels and the Senate Parliamentarian to all offices about the laws and precedents surrounding the budget could better serve to inform Senators of how the act works. This, too, could bring more and new order to the process.

As well, in addition to Bill and Marty, I would strongly recommend that by unanimous consent at least there be more debate time allowed on the resolution and on any reconciliation bills it orders. Since expedited voting adds appreciable time to considering budget bills, being realistic and accommodating that time during resolution consideration may help ease, if not eliminate, expedited voting without ever changing the law. These types of changes, and

others discussed this morning, which can be taken in cooperation between majority and minority, seem to me to be a reasonable starting point of work between the Chairman, the Ranking Member, and the two leaderships on the issue of expedited voting.

Thank you, Mr. Chairman, and all of us would be happy to answer any questions that you and Senators might have.

[The prepared statement of Mr. Ueland follows:]

Senate Budget Committee
October 4, 2011
"Improving the Budget Process:
Strategies for More Effective Congressional Budgeting"
Eric Ueland

Mr. Chairman and Senator Sessions, thank you for the invitation this morning to speak briefly and answer questions on vote-a-rama, the Senate's practice of expedited voting at the end of budget resolution consideration. I welcome the opportunity to be here with Bill and Marty, who I respect greatly. The views expressed here today are my own.

I've thought a lot about the criticisms of expedited voting, as well as some of the ideas for changes I've heard over the years. This triggered a few questions which frame my testimony:

First: do proposed changes affect the ability of Senators to carry out their responsibilities, or risk curtailing if not eliminating Senatorial rights?

Second: is there value to the current system?

Third: what are some implications of a new process?

And, fourth: are there other ways to handle the concerns of Senators?

Let me briefly look at the questions, and offer some answers.

First, do the proposed changes affect the ability of Senators to act on their responsibilities, or risk curtailing if not eliminating Senatorial rights?

Senators reflect many different roles. For example, they represent their State, their voting coalition, their conference, this Chamber; they are leaders in their communities, in professional and peer groups; these, and many more roles, all have merit. Senators examine, review, question, assess, and render their judgment on matters. And multiple influences guide a Senator as she decides how to vote.

Both the resolution, and amendments offered to the budget resolution, provide Senators the ability to create a record for Congress to know the details of alternatives to address the fiscal house of the nation, and can reflect any of the disparate roles that Senators hold. Clearly, one of a Senator's roles is political. And because Senators are politicians, I'll be the first to confess that I've sometimes seen politics at work both inside a resolution by a majority, and out on the Senate floor with amendments proposed to it from a minority.

But, as former Republican Leader Trent Lott used to say, "Good policy is good politics." In this instance, taking steps that could appear to restrict Senators from offering amendments, just because of concerns over their political nature, seems to go too far. All Senators dislike the fact that since the early 1990s, this Committee has had a political yardstick more frequently

applied to its work. To me, a lot of this could come from changes in how the media report on budget items, the rise of the Internet, and the more aggressive role of various interest groups interpreting the meaning of the resolution. Ideas which might curtail expedited voting because of concern over politics don't necessarily address any of these factors.

Further, over the past few decades, Congress has passed multiple laws which restrict or eliminate Senators' rights to amend, like the Budget Act. It powers a budget through the Senate with a balance between its majoritarian framework (a privileged bill that can't be filibustered and only needs a simple majority to pass) and some respect for limited minority rights (debate time, the ability to offer amendments and seek votes on or in relation to them).

But at least under the Act, a Senator can seek a vote to garner the support of 60 percent of his colleagues to open the door to an amendment being added to the resolution. This supermajority requirement does crowd minority rights, but is more than Senators are allowed in other procedural circumstances, such as certain appropriations matters. To the extent that reforms to expedited voting could be seen as eroding the rights of any minority under the checks-and-balances included in the Act, that runs the risk of accelerating the trend of laws which sometimes makes the Senate look more like the House. One thing that unites Senators is the instinct that the Senate shouldn't end up looking like the House, just with larger districts and fewer Senators. It is possible that impeding expedited voting could fly in the face of this convention.

A second question: is there value to the current system?

I think yes. Watching different leadership teams manage ever more-complicated budget resolutions, they repeatedly run up against the reality that there just isn't enough debate time to handle all the topics covered by the resolution.

It is a fact that within debatable time, a majority often wants to cure, modify, highlight or amplify key matters through debates and votes. While a majority tries to win support of its Senators before the resolution goes to the floor, the ability to offer a vote at the end of the process to a Senator can help in the negotiations over gaining, or retaining, a Senator's support. Further, taking a stand, and making a point, on a budget resolution isn't unique to just the minority party.

Conversely, the minority party often has more amendments than it can handle during its debate time, as they learn what the resolution contains and try to lay out different paths forward. Their leadership evaluates what serves their conference best. The expedited voting process creates appropriate options for leaders and Senators to cooperate on what to emphasize and when.

The opportunity to act also serves as a relief valve to keep frustration over the fast-track budget process lower than it otherwise might be. Were Senators further restricted on amendments, their level of cooperation in a new process where it is even harder for them to participate could trigger unpredictable results. For example: from setting the opening time to closing down the Chamber at day's end, much of the Senate's work in a typical day is done by unanimous consent. Imagine no unanimity, and no consent. A frustrated Senator could bring about a stark change in how the Senate operates.

Third, what are some implications of a new process?

Some more popular changes I've heard talked about expedited voting include: a filing deadline, in the hope that it might allow the Senate more time to evaluate amendments; shortening the allowed debate time for amendments; or, even limiting the number of amendments a Senator can offer. All trigger some implications for consideration.

For example, while there is value in Senators having the chance to see all the amendments before voting begins, it's also possible a filing deadline with a tradeoff of shorter debate time on amendments could lock out Senators being able to address new matter that could be added to the resolution by amendments on the list. As well, once an amendment goes on a serious list in the Senate, Senators often want debate and a vote on their proposals. And, since a filing deadline often seems to stimulate more, not less, amendment activity from offices, there could still be a lot of amendments available once time expires, and you would then be right back where you started: more amendments and no debate time.

On a practical matter for the Committee, given the very complicated aspects of the Budget Act, a majority needs the ability to send to the House all that can pass legal parliamentary muster in the Senate once a conference report, or privileged message, returns. While a filing deadline could create a finite amendment list, the majority will need to preserve its option for yet another amendment before final passage, which, in fairness, ought to be available to the minority as well. Due to this, at the end, the finite list might not be so finite, after all.

As a result, in addition to longer consideration of the budget in the Senate, and robust expedited voting, the majority "last amendment" would feed the perception of further dominance of the majority over the minority.

In cloakrooms and on staff benches, some have talked about limiting the amendments a Senator could offer to a budget resolution. But preventing Senators from offering expedited voting here may just encourage them to offer their ideas on other bills during the year. While expedited voting can make Senators uncomfortable, allowing Senators to act here may actually

be helping the Senate more easily move other, completely unrelated bills, across the Senate floor.

Given how majorities and minorities switch around, it's also important to keep in mind that rights a majority may want to take away now could be of renewed value to those Senators if someday they enter the minority.

Since this is the Budget Committee, I've necessarily focused on the budget resolution. But the Budget Act also covers many essential elements of reconciliation as well, which former Republican Leader Bob Dole once described as "firing with real bullets." Just one reconciliation bill can create, delete, expand, shrink, or alter trillions of dollars of Federal expenditures and taxes. Reconciliation debate time is so short--just twenty hours--and its rules in practice so complex, that making it harder to amend reconciliation should require a lot of separate thinking about the ins and outs of reforming expedited voting.

Finally: Are there other ways to handle the concerns of Senators?

The current expedited voting process is the distilled essence of the Senate at work. While many may criticize its form, chairmen and ranking Senators working together on the process have successfully administered all expedited votings that have occurred since the Budget Act was written. The process can be long, but when run successfully, accounts for the need to share information and allow Senators some breaks during the process. This hard work, blending multiple Senator interests, always ends expedited voting. No budget resolution or reconciliation bill has failed to pass due to the expedited voting process. To me, such a failure due to expedited voting could be the trigger for considering statutory reform.

But right now, moving ahead when the Senate has not had an expedited voting process on a budget resolution since 2009, and on a reconciliation bill since 2007, I think caution about change is in order as new Senators over two Congresses now haven't yet had the opportunity to experience, and understand, the pluses and minuses of expedited voting.

If there continue to be complaints about the expedited voting process, though, rather than considering acting on new laws, precedents, rules, or standing orders, I would recommend using a different model to review reform ideas, similar to what was successfully done on holds.

The recent changes to the hold process is the result of work starting in the early 2000s. Here, Senators brought their concerns to their leadership; through several different Congresses, the leaderships made efforts to gather information and test out new procedures; and, ultimately, the whole Chamber agreed to changes which benefited from both the systematic work from before and a fuller understanding of the issues at stake by Senators.

If Senators ever chose to act to change expedited voting, I think the Senate would benefit from that type of process here, where a thorough investigation and consideration of trying out new procedures temporarily over time allows Senators to weigh the balances and trade-offs of various reforms. If or when there is a final decision taken by a Senate to make changes, then they might receive broad bipartisan buy-in, and be enduring.

And there are many things that the Committee could try before acting statutorily in any way that could be seen to reduce minority rights.

For example, a majority could right now simply create more time for review of the Committee mark before committee action begins; and allow more time between the reporting out of the resolution and commencing action on the Senate floor. Up to a week in between, rather than the current Committee practice, would allow for a clearer understanding of the resolution's contents and reduce the pressure to act and counteract which plays out during markups and floor action.

In the intervening period between reporting and starting action on the Senate floor, an annual presentation by Committee counsels and the Senate parliamentarian to all offices about the laws and precedents surrounding the budget could better serve to inform Senators of how the Act works and give them the ability to know with more certainty and clarity what amendments and motions can fit the resolution out on the floor. This, too, could bring new order to the process.

As well, I would strongly recommend that by unanimous consent there be more debate time allowed on the resolution and on any reconciliation bills, as much as 100 hours. Since expedited voting adds appreciable time to considering budget bills, being realistic and accommodating that time during resolution consideration may help ease, if not eliminate, expedited voting naturally. Additionally, when the Act was adopted, 50 hours of resolution debate was deemed worthwhile for a Federal budget with outlays of less than $300 billion. Today, with a budget whose outlays are closing in on $4 trillion, more time seems in order.

These types of changes, and others, which can be taken in cooperation between majority and minority, and which are short of those which Senators might see as curtailing expedited voting, seem to me a reasonable starting point of work between the Chairman, the ranking member, and the two leaderships on the issue of expedited voting.

In any event, thank you, Mr. Chairman and Senator Sessions, and all of us would be happy to answer any questions you and Senators may have.

Chairman CONRAD. Well, thank you. Very thoughtful, Mr. Ueland. Very thoughtful. This has really been an excellent panel, and you have given us lots of food for thought.

I would just say to you that around here sometimes there is a moment in time to get things done. I have been on this Committee for 25 years. I started way down at the end. And these last 2 years have been the most frustrating of all because we need a budget process; we need a budget debate. And this Committee kind of got big-footed this year by special negotiations going on at a much higher level; that is, the leadership of the House and the Senate, Republican and Democrat, joined in negotiations with first the Vice President, then the President himself, and I was told repeatedly, "Do not go forward with a budget resolution because we might need to use reconciliation to implement whatever agreement we make. And it would not make a whole lot of sense for you to run a resolution through the Committee and 3 weeks later you would be in here with a leadership agreement that needed to use reconciliation provisions for implementation."

And so we have wound up in this unusual situation where we did not have a budget resolution go through the normal process. I would say to my colleagues we do now have a budget in place in the sense that a deeming resolution has been adopted in the Budget Control Act. It establishes the budget for the next 2 years. We know what the budget is going to be for the next 2 years. It is in law. And we have 10 years of spending caps in law. It is done. And this special committee has been given, in essence, the kind of power that you would have in a reconciliation process to deal with entitlements and revenue. They can come up with a proposal and come back, no ability to filibuster. That is a mirror of the reconciliation process.

But, look, I do not think it is in the long-term interest of the institution to function this way. This Committee has got to have meaning, and this process has got to have meaning, and for it to have meaning, there has got to be an opportunity to act.

I can tell you, trying to convince the leadership to go to a budget resolution process, especially with vote-a-rama, where Senators in many cases literally are not sure what they are voting on—and this is—I mean, it is the case. I have been through it 25 times, and it has gotten worse and worse and worse. You have got more and more votes after all time is expired with literally no debate time.

Now, that does not bring respect to this institution. I mean, the proof is in the pudding. We are not doing budget resolutions through the normal process. The place where I might agree with some of my colleagues, we got a budget in place. We got a budget in place through the Budget Control Act. But it is a very frustrating way to have proceeded. We did not have, I think, the kind of debate in this committee, the kind of debate on the floor, that our colleagues deserve and that the nation needs.

So, Mr. Ueland, I have enormous respect for you, but the notion that we do not do—make a change here leaves me pretty cold, because this, to me, is not working, and I have been here 25 years. I have been in the majority. I have been in the minority. I am acutely aware that that can change. But, boy, I tell you, I am

strongly in the camp of moving to a biennial budget and doing something to reform this vote-a-rama process.

Senator Sessions, I have kind of used my time with these observations. I go to Senator Sessions out of respect for your time.

Senator SESSIONS. Well, thank you. The vote-a-rama is a frustrating thing, and this is a grim period, I will acknowledge, although there are people in our leadership that are very uneasy about eroding one more right of the minority, I have got to tell you.

But, look, the votes are not quite so horrible. If you look at 2001, there were 15 roll call votes. Two-thousand two, I do not see, 2003, 20.04, 15, 2005, 17—no, there are more than that. Two-thousand-four was 38 and 25 and 20 and 16 and 44 was the last one—no, the time before last, 27. So these are significant, but it is not as if it is—with the little debate time, it is not as if it is destroying the whole ability of the Senate to get through the budget process and get a final passage. It is just not. So I just push back on that.

The reason Senator Reid said it is foolish to have a budget this year and put a kibosh on it, I do not believe, was the vote-a-rama. I believe it was because the President's budget was so irresponsible it could not get any votes when eventually it was brought up without debate, basically, and voted on, and it would have put his majority in the difficult spot of having to produce a budget, and it would have had to be scored and people had to know how much it is going to reduce the deficit, how close it comes to balancing the budget. The House had produced a tough budget that I think was historic and worthy of respect, and so they chose to punt, and I do not believe it was vote-a-rama.

So I do not know if we do a two-year budget. I am not sure we are going to be much better off when we face those kind of circumstances than we do.

I thank all of you for your comments. I do not slam the door on reforming and having an open mind about vote-a-rama. If we can make this better, I am willing to talk with you about it, Senator Conrad. I know if it could help the process in some way, I would be worthy of it.

I guess my thought is, what do we do about going forward with a budget, I mean, appropriations process without a budget, or what do you do to enhance the certainty that we pass a budget at the time we pass it? It should be relatively early, would you guys not agree? You have been through the process, Bill, and the appropriations and all. The Appropriations Committee needs to know what its allocations are soon, just as a matter of policy.

Mr. HOAGLAND. And I would just simply say that since you have passed the Budget Control Act, you have set the 302(a)s practically for the next ten years. So at least the appropriation process has their guidelines, because the committee, though we talk about moving the appropriations from one subcommittee to another, you do not have that authority. All you have the authority to do is to set the 302(a). So the focus back here now is on entitlements and revenues. This is the committee to focus on it.

Senator SESSIONS. Mr. Ueland, do you have a comment on that?

Mr. UELAND. Well, I think Bill is absolutely correct. In terms of the previous conversation on vote-a-rama, in case I was not clear, Mr. Chairman, attempting to make a very explicit dividing line be-

tween statutory changes too early and ideas building on the cooperation already in existence between the majority and minority about things that, under your control, you have the ability to take action on which could influence the end of the process vote-a-rama by addressing some of these other issues at the beginning and the middle of budget writing, budget mark-up, and budget action out on the floor.

Chairman CONRAD. Let me just say, you know, we have got some colleagues who—on both side—to me kind of abuse the process. I mean, I have seen it. I could write a list. Bill, you and I could sit down and we could agree on a list. We would have 80 percent agreement. We know what is going to happen. There has got to be a better way. I just think it is demeaning to the Senate to have people voting and they do not know what they are voting on. There has been maybe two minutes of debate on very fundamental things. That is not good. That is not good.

Senator SESSIONS. I understand that, but one of the big, big things is that the Senate is a unique institution. It has the opportunity to play, I think, a big role in the long-term challenges facing America. People sort of look to us as the saucer that cools, and we have got the entitlement programs that I know you are willing to talk about, Mr. Chairman, and Bill mentioned this committee needs to confront. I am, too.

But if you talk to people who have been real experts in the Senate over the years, we are reaching a point where it is becoming more like the House, and this Committee of 12 and the process on that was, in a way, a diminishment of Senatorial traditions. We have got a situation in which one very respected historian on the Senate said, when you fill the tree as often as we are filling the tree today, eliminating the ability of the minority to offer amendments, you have really altered the Senate. The Senate can fight back, I think. Members of the Senate could fight back, but we have not done that effectively, to end that process.

But in that sense, it comes down, Mr. Chairman, to the leaders. They pick their committees and they send down their message and then you do not get any amendments and it does diminish the individual Senators' little power——

Chairman CONRAD. Yes.

Senator SESSIONS [continuing]. That he thought he had when he got elected to this body.

Chairman CONRAD. Yes.

Senator SESSIONS. So I do think we need to think about that. I see Mr. Hoagland had a further comment. I would yield. Thank you for this good panel.

Chairman CONRAD. Thank you.

Senator Begich, did you have a question?

Senator BEGICH. Mr. Chairman, just a comment. First, I want to again thank the panel here and the panel before, and I agree that this was a very good meeting. I hope it whetted our appetite enough, and I like your idea of moving forward on, potentially, Thursday.

I guess as a new member, I recognize—I subjected myself to the vote-a-rama. It is the process of—a democratic process that we are going to be voting on things that we may not like. The real issue

is how really germane they are to the budget, and I think that is—we can narrow that down, because there is no other body I have served in or worked in or have worked around that you can bring in an amendment that has no relation to anything that is on the floor or any relevance to anything on the floor and bring it up because you are frustrated because your bill did not get heard or whatever it might be.

I think, to me, if we can narrow in on—because I do think that the format of the budget process vote-a-rama, honestly, I do not mind if there are 100 amendments. We are elected to vote. We have got to take tough votes. We are one of a hundred out of 308 million people in this country that are fortunate and honored to be in this body, so we are going to take tough votes. That is life in the big city, and six years later, you live or die by those votes. But they should be relevant to the issue we are on, and I think both sides have taken advantage of those.

And the other piece that I think is another is this crazy quorum call allocation of time. You know, when I first came here, I thought, well, that is going to count toward—and it does not. And so there is no debate. I mean, let us be real about this. Some of us might rush off, go speak for five minutes and leave the floor. No one is in the chamber. This is the one thing I always get from Alaskans that visit me after they have gone. I have given them, you know, we all have these tickets we can give. They can go view, and then they come back and say, well, when does the debate start? And I say, well, you are watching it. There was one person.

So I think in a lot of the cases, the areas that I would focus on the vote-a-rama issue is tighten up the germane issue. I agree on the Sense of the Senate. Those are just political statements that people put into campaign commercials later. Limit those. Quorum call, allocation of time.

And then if members cannot get their act together and give an amendment that is 24-hour notice, then they should never be offered anywhere, because—totally irresponsible. I mean, we are one of a hundred out of 308 million people. In theory, we are responsible people. If we cannot think of an amendment on a budget until three minutes before you are debating, or are going to vote on the budget, you are totally irresponsible and the public deserves better. So I think there should be a time limit on amendment submittals, that if you do not have it in by this date, too bad. I do not even care if it is the Golden Goose amendment that is going to be a great thing for all of us.

There is a process people have to respect for the proper debate and discussion to occur in this body, because I think, Senator Sessions, you are right. We are kind of the cooling sauce at times. But you cannot cool things when you suddenly have 50 amendments three minutes before you vote. That is irresponsible.

So those are the things that I would hone in, as a new member who experienced this kind of vote-a-rama, how do we make sure. And then if you are not responsible enough to review it over the 24 hours, then maybe you should not be in the Senate. I will leave it at that.

Chairman CONRAD. Senator Whitehouse.

Senator WHITEHOUSE. I would concur with what Senator Begich just said. I think you need to combine the two, because the germaneness requirement is meaningless unless there is a real pre-filing requirement so people have a chance to look at it.

The Chairman has observed that in the vote-a-rama process, very often, Senators do not know what they are voting on. It is actually worse than that. Some of the bills that come up say that their title concerns something and the content of the bill is completely different. So it is very misleading in that sense, and you do not have time to plow through it, and because you do not have a chance to see it coming—they can be filed literally on the floor during vote-a-rama—there is no chance for any kind of review. So something comes up suddenly, poof, it is the, I do not know, In Favor of Mom and Apple Pie amendment, and everybody is for Mom and apple pie, and then, pow, you find out that down in the text of it later on was something completely unrelated to Mom, completely unrelated to apple pie, basically there was a submarine buried in that that nobody saw.

So that kind of behavior, I think, would get discouraged if there was a combination of a germaneness requirement and a pre-filing requirement, and I think, as Senator Begich said, if you cannot figure out what your amendment is going to be 48 hours before vote-a-rama or whatever the time frame is, shame on you. So I think that is something that we could be expected to live with.

The other thought, which is a little bit more contrary to traditional Senate procedure, would be during the vote-a-rama, you could have not just aye votes and nay votes, but you could have an aye vote, you could have a nay vote, and you could have a "this is just too silly to vote on" vote, and if a whole lot of Senators checked off column three, you would not want to be the sponsor of that amendment, and that would provide a little peer pressure to have the amendments—because we know when we go down there to vote, there are a lot of times when people look at each other and say, you know, this is just too damn silly to vote on, but there is no way you can express that if your choices are aye and nay, and passing does not have any meaning. So you might want to think about a third column that says, "too darn silly to be worth my vote" and see if that would work.

Chairman CONRAD. You could probably make a statement——

Senator WHITEHOUSE. You would have to make it more Senatorial, but——

[Laughter.]

Chairman CONRAD. Bill.

Mr. HOAGLAND. Mr. Chairman, would you permit me a personal comment before we end here?

Chairman CONRAD. Yes.

Mr. HOAGLAND. I may never have another opportunity to say this in public. I will never forget the first hearing you attended, and I was sitting there where Mary was, behind Senator Domenici, when you came to the Senate, and you were way down here where Senator Begich was. And you made a statement that "I will not run for office again unless the budget was balanced," and I sat there and said, oh boy, he may regret that.

Well, we eventually got to a balanced budget, then we lost it, but I have never regretted that you will have continued to serve this committee and this country for the many years you have. So thank you.

Chairman CONRAD. Thank you, Mr. Hoagland. You know, I came to the end of that first term. We had not balanced the budget. I announced I would not run again. For five months, I thought I was out of here. My staff was leaving. And then the other Senator died and I was nominated to run in a special election. Senator Dorgan, who was in the House of Representatives, ran for my seat, so I ran to fill out the two years remaining on my colleague's seat who passed away, and it is something I never regretted doing, announcing I would not run again, because I had made that pledge, if the deficit were not reduced, I would not. And people, a lot of people thought that it was very strange because the polls showed I could win handily even if I had chosen to run for my seat again.

You know, the night before I announced I would not, I thought to myself, I just do not want to be another guy that made a promise and did not keep it. So for those months, I was really thinking I was leaving this place and making provisions for my records to go to the university and all the things that you do when you think you are leaving, and then I will never forget the fateful call I received that Senator Burdick had passed away. And they did a poll back home and two-thirds of the Republicans thought I should run again. [Laughter.]

So it made me the answer to the trivia question, because I am the only Senator in history that served in both seats from the same State in the same day. So if you are ever asked that question, you now know the answer. [Laughter.]

I thank you all very much.

[Whereupon, at 12:15 p.m., the committee was adjourned.]

Bill Nelson

United States Senate
WASHINGTON, DC 20510-0905

BILL NELSON
FLORIDA

Senate Budget Committee
ATTN: Joan Evans, Chief Clerk
Questions for the Record
Improving the Budget Process: Strategies for More Effective Congressional Budgeting
October 4, 2011
From: Senator Bill Nelson
For: Mr. David Kendall, Ms. Maya MacGuineas, and Mr. Donald Kettl

Question 1:

The Congressional Budget Office (CBO) estimates the federal government will spend $3.6 trillion in 2011. That number excludes $1.2 trillion in tax expenditures – the various credits, deductions, and exclusions grafted onto the tax code. Edward Kleinbard, the former chief of staff of the Joint Committee on Taxation, has suggested that CBO should treat tax expenditures as spending for purposes of budget accounting. If Congress adopted this change, it would show that the federal government actually spent $4.8 trillion in 2011, not $3.6 trillion. By making this change, he argues the size of government – its handprint on the private economy – would no longer be hidden. Tax expenditures would be more transparent and subject to open and highly visible competition through the budget process. *Do you agree? Should we bring tax expenditures "on budget"?*

Question 2:

Tax expenditures, once enacted, are very hard to repeal. We still have oil and gas tax subsidies that were created in the 1920s. *Do we need a formal and regular process for reviewing tax expenditures to ensure they still align with public policy objectives? What should a formal review process look like?*

IMPROVING THE CONGRESSIONAL BUDGET PROCESS

WEDNESDAY, OCTOBER 12, 2011

COMMITTEE ON THE BUDGET,
U.S. SENATE,
Washington, DC.

The Committee met, pursuant to notice, at 9:33 a.m., in Room SD–608, Dirksen Senate Office Building, Hon. Kent Conrad, Chairman of the Committee, presiding.

Present: Senators Conrad, Cardin, Whitehouse, Warner, Merkley, Coons, Sessions, and Thune.

Staff Present: Mary Ann Naylor, Majority Staff Director; and Marcus Peacock, Minority Staff Director.

OPENING STATEMENT OF CHAIRMAN CONRAD

Chairman CONRAD. The hearing will come to order.

I want to welcome everyone to the Senate Budget Committee today. As we discussed in our Committee meeting last week, Senator Sessions and I are working to write a joint letter to be submitted to the Joint Select Committee on Deficit Reduction with recommendations from our Committee on reforming certain aspects of the budget process. Our letter will focus on areas where there is broad consensus within the Committee.

Today's hearing follows up on certain issues members raised last week. In particular, today we will consider whether the administration should be involved in the budget resolution. I think this will come as a surprise to most Americans who may be listening that they are not, but the fact is the budget resolution is entirely a congressional proceeding. The President does not sign it. While he does submit a budget to us, he does not have a role in passing a budget resolution in the Congress.

Today's hearing follows up on those issues as well as talking about options for encouraging congressional action on budget resolutions because I think one of the great frustrations of this Committee—and we have seen this repeatedly, especially in election years, is budget resolutions are not being passed.

We have three knowledgeable witnesses with us today: Dr. Louis Fisher, a scholar in residence at The Constitution Project; Dr. Philip Joyce, professor of management, finance, and leadership at the University of Maryland School of Public Policy; and Dr. Paul Posner, the director of the Centers on the Public Service at George Mason University's Department of Public and International Affairs. Welcome to you all. These are really three excellent witnesses on the subjects we have before us.

I want to begin just by briefly highlighting how a joint budget resolution might work, and I want to acknowledge the work of our colleague Senator Thune, who has presented his own proposal that was well thought through, I thought, and carefully done.

First, Congress would pass a joint budget resolution which the President would then sign. The joint budget resolution would become a statute with the force of law. It would no longer be a congressional-only budget framework.

Here are some of the options for what could happen if the President and Congress failed to reach agreement on a joint budget resolution. We could add expedited procedures for a concurrent resolution, a congressional-only resolution, if the President vetoes the joint resolution.

And we could provide for an automatic continuing resolution if appropriations bills are not enacted before the beginning of the fiscal year.

Here are some of the arguments for moving to a joint budget resolution: Number one, it would encourage an up front, comprehensive agreement on budget issues. Two, it would bring the President to the negotiating table earlier in the process, and this may help provide clarity to the process and decrease brinksmanship later in the year. And it could strengthen budget enforcement with the addition of statutory provisions.

But there are also arguments on the other side against moving to a joint budget resolution, and we have certainly heard them, especially in this last week as we have considered our recommendations.

One, it would create a new fast-track vehicle for making substantive statutory changes. This means it would be possible to enact statutory budget enforcement changes with only a majority vote. For example, the sequesters that we just established in the Budget Control Act could be turned off with a simple majority vote. I must say I had not personally thought of that, but that is something we need to consider. A line-item veto could be enacted with a simple majority vote.

Second, requiring the President to agree on the budget would also increase the likelihood of delays in the budget and appropriations process. It is hard enough to reach agreement between the Senate and the House. In fact, in recent years it has proved impossible. Adding the President to the mix might make it that much harder and that much more likely there would be no agreement at all.

Third, moving to a joint budget resolution would also shift some power to the executive branch. It would undermine the congressional independence and limit Congress' power of the purse, which was really, as I go back to the history, how we got into this to begin with. It was part of the 1974 reforms.

Senator SESSIONS. Do you remember that?

Chairman CONRAD. No, I do not. But I have gone back, and we have researched this. What was the rationale? What was the argument that was advanced? Because, you know, it is counterintuitive that you do it the way we do it. I mean, frankly, as somebody that comes from an executive branch of government before I served

here, what Senator Thune is proposing appeals to me as sort of a common sensical way to proceed with the budget.

So I think there are strong arguments on both sides of this, and today's hearings will also consider measures we could adopt to encourage Congress to pass a budget, additional tools that could be given to strengthen the need to do a budget in these chambers.

We could strengthen the Budget Committees by increasing their membership to include members of the Democratic and Republican leadership as well as Committee Chairs. The original idea of the Budget Committee is that the Chairs of the Finance Committee and the Appropriations Committee would serve here. And for many years, that was the case. You will recall Senator Byrd served here. Before that, the Chairman of the Finance Committee served here. And it was really designed to be made up of the Chairs of the key Committees. Now we have gotten away from that over the years, to the detriment, I think, of writing budgets.

We could strengthen the right of Senators to proceed to and debate a budget resolution if the Budget Committee or the Senate fails to act. This I find particularly appealing because I have found in arguments or discussions with leadership when you point out if the Budget Committee fails to act, any member can bring a budget to the floor. Right?

If we do not act by April 15th, any Senator can bring a budget to the floor.

The problem is you still face procedural hurdles, and the deference given to the Majority Leader really has precluded, even though a budget is filed, from having a motion to proceed. And that I think is something we really need to think carefully about.

If the Budget Committee fails to act, any Senator can file a budget, go to the floor and file a budget. The key then is: How do you get it before the body? You still face a motion to proceed. And I think we have to discuss how we could strengthen that right of a Senator, if the Budget Committee fails to act, to get a budget considered by our colleagues.

As we have already discussed, we could reform the vote a-rama process to encourage more substantive floor debate. We could create a 60-vote point of order against appropriations spending and revenue bills until a budget resolution is enacted. Senator Cardin has put together, I think, a very constructive proposal to require other business basically to stop until a budget resolution is produced. And we could establish an automatic trigger with spending and tax expenditure reductions as a consequence for not enacting a budget resolution.

Let me just say, after hundreds of hours of negotiations with Republicans and Democrats on possible triggers, I do not think that has much prospect. I have spent hundreds of hours on possible triggers, and I have not been able to find a place where both sides could agree.

So we would like to hear our witnesses' views on these possible incentives and welcome any additional ideas in this area. With that, we will turn to Senator Sessions for his opening remarks. Then we will go to the witnesses, and we will then turn to our colleagues for their questions and comments. Senator Sessions?

OPENING STATEMENT OF SENATOR SESSIONS

Senator SESSIONS. Thank you, Chairman Conrad. That was a good overview and some very astute observations about the choices and difficulties we face.

I do believe we need to strengthen the budget process, and I do believe we can do that, and perhaps there is a rare opportunity at this point in our history to get it done.

I also believe, and have for some time, that a 2-year budget would be better for the country, and I have felt equally important is a 2-year appropriations process. It just makes sense to me that with the difficulties we have in getting appropriations and getting budgets passed, you could do it for 2 years, and the agencies and departments of Government could operate more efficiently. They could be more effective and give more time for oversight for the rest of the Government, and hopefully we could reach an accord on some of these issues.

But I certainly am willing to listen to those who have different views about it because things are not always as they appear around here. Good intentions do not always play out as you expect them to in the years to come as people redefine and figure out ways to advance their agendas based on language in a bill in a way that they never anticipated.

So I am disappointed that we have not had a budget now in over 2 years. We do need a process that makes that impossible or very difficult. I propose the 60-vote point of order. I am not sure that is the only way or maybe even the best way to ensure the budget process moves forward. You made some good suggestions that I think are worth considering, but I have proposed that you should not appropriate money until a budget is in place and that any Senator could object by raising a point of order, which is now 50 votes, to raise to 60 votes until a budget is passed.

With regard to the President's participation in the statutory process and the President's signature or veto, I am in a show-me position. I would like to see someone convince me that that is the best. I do have a sense that it would provide a powerful presence throughout the entire process, always looking at the President's veto and objections, that it might dominate the diffuse Members of Congress and make it harder to either get a budget, number one, or to increase unnecessarily the President's position. We tend to focus on that often by what we see in today's short-term political world. We need to look at it in the long-term world. Is that the right and better process? Senator Thune has given a lot of thought to it, Senator Cardin has, and I am open to hearing about that and to thinking through the constitutional ideas about it.

So I think we all ought to be accountable. I think we should do our business in public. Even the Senate Committee of 12 basically will not tell us what they are talking about. It is really a secret what they are doing. We have had secret meetings all year. I truly believe the Republic would have been better off had we just had a long series of debates and votes so we figured out where we are, where the votes are, and then after you have given your best effort to advance your agenda and it is clear to your supporters that you have done all you can do and you cannot win, then sometimes it provides a better opportunity for a compromise than to think we

are going to compromise over here and bring it out without a debate on the floor.

So thank you, Mr. Chairman, for having the hearing. I look forward to these good witnesses, and I do hope we will work hard to see if we can accomplish something in the next few weeks.

Chairman CONRAD. I thank the Senator, and I thank the Ranking Member and his staff for the collegial effort that we have had underway. It is how this place, I believe, ought to work, and we have got differences of opinion, but we have been able to work in a very constructive way, and I want to thank the Ranking Member for that.

Senator SESSIONS. And could I just say, every time I think I am firmly convinced of something in this process, and you hear somebody make a good argument on the other side, you realize these are not easy answers. So I look forward to the hearing.

Chairman CONRAD. I do, too.

We will turn now to the witnesses, really an outstanding set of witnesses. We will start with Dr. Fisher, scholar in residence at The Constitution Project and somebody who has had a lifetime of experience wrestling with these issues. Welcome, Dr. Fisher, and please proceed.

STATEMENT OF LOUIS FISHER, PH.D., SCHOLAR IN RESIDENCE, THE CONSTITUTION PROJECT

Dr. FISHER. Thank you, Mr. Chairman, Ranking Member Sessions. My attitude about budget reform comes from, as you suggest, my involvement. I came to Congress in 1970. I had done work in the impoundment area, so I was with the Senate Judiciary Committee for several years, and I was very positive about that. I thought President Nixon had abused the process by refusing to spend appropriated funds. I think Congress had to do something to defend itself. And there are many other parts of the Budget Act of 1974 I worked on. I was very happy to see the Congressional Budget Office created to give Congress independent access to its own numbers and projections.

I did not like then and I still do not like now what Congress did in the 1974 act in centralizing its system and trying to be very comprehensive. I know Congress has to have all the pieces together to look at the budget in full. That is very, very important. What I did not like is that President Nixon and members of the Nixon administration attacked Congress and blamed Congress for the deficit. At that time they were about $25 billion a year. And, in fact, if you look at the record, there is no basis to complain about Congress or its procedures. But that is what President Nixon did, and that is what people did, saying that Congress is irresponsible because it has a fragmented system.

And, in fact, if you look at the years that Nixon was there, Congress cut his appropriations by $30 billion and did add some backdoor spending by $30 billion. So if you look at Congress, no matter how fragmented it was, it was responsible on the aggregates. It did not add to deficits. Where the deficits were coming from was the lack of responsibility on the part of Presidents in submitting budgets to Congress that were in deficit and not taking care of them where they should. And that is my principal point today, that I

think if Presidents submit a responsible, credible budget, Congress through any system it has can work well. If a President does not do that, I do not think any budget process in Congress or any reform is going to make a difference. And I do not know why, in all the hearings I listen to, all the attention is on the failures of Congress, and no one seems to look at where the budget gets started.

So that is going to be my point, and if you look at what happened in 1921, we did not have a Presidential budget until the Budget Accounting Act, and there were deficits coming along. Certainly with World War I you could understand, and it was decided—and I think this is correct—that the only person in the country who can get the budget off on the right start is the President. Therefore, the 1921 act put on the President the personal, non-delegable duty to get the budget off on the right start on aggregates. Then Congress basically would live within those aggregates and then change the priorities any way it wants to by a simple majority vote. That is the constitutional authority of Congress. So that was the institutional deal, and it worked very well over the years.

I will say that in 1921 there were people who wanted to subordinate Congress to the President; that is, no member could increase an amount unless they got permission from the Secretary of the Treasury or unless you got a two-thirds majority or unless, unless. And Congress says, no, you send up the budget, that is an executive budget, and when it gets here, it becomes a legislative budget, and we will do as we like, any changes that we want to make. So Congress protected its constitutional powers.

What went wrong? President Nixon publicly condemned Congress. He ridiculed Members of Congress for their "hoary and traditional procedure," permitting action on different spending programs "as if they were unrelated and independent actions." I have already told you that that was an irresponsible statement from the President, that Congress was responsible on the aggregates. There is no question about that.

Unfortunately, Congress itself picked up that theme, and there was a congressional reform committee that concluded also that, as they say, the fault was the decentralized nature of Congress and the failure to arrive at congressional budget decisions on an overall basis. That was false.

Congress at that time had these scorekeeping reports, so every time any element of Congress did anything to the President's budget, it was picked up by the scorekeeping reports, and you could tell whether Congress was above budget or below budget. So there was accountability. It was not a chaotic process at all.

Now, you get the Budget Act in, and everyone seemed to like it at that time. Anything that was centralized or coordinated seemed to be good things, and no one knew exactly where that was going to turn out. So let me tell you what happened with the new process in 1974.

The deficit in 1981, when President Reagan came into office, was $1 trillion, so it is above 14 and still climbing. So something went wrong, and I think what went wrong is the lack of Presidential leadership in presenting a responsible budget. And if you get off to a good start there, you are in good shape.

The problem is that if you have multiple budgets—when you had one budget, everyone knew it was above budget or below. It was very simple. If you have the President's budget and then a House budget and a Senate budget and so forth, it gets confusing. And someone can say this bill is below budget. It might be above the President's budget, but it is below the budget resolution. So you start getting cloudiness and lack of accountability and not fixing responsibility on the President.

There is a problem that once the budget resolution was adopted, instead of in the past committees trying to come under the President's budget to show savings, now there is pressure under the budget resolution for committees to come up to the budget resolution, and the Appropriations Committees were under that pressure. So that was a difficulty.

It was very interesting in the Reagan years when deficits exploded—and I will explain why is that Congress, by the mid-1980s, even though they had this new process that was supposed to allow them to be coordinated, they could not handle deficits. They went from the $25 billion a year under Nixon to around $200 billion a year under Reagan, and that is when you got into Gramm-Rudman, which was a catastrophe. Then you went into Gramm-Rudman II, a catastrophe. And what happened? And I think what happened was in 1981, although the budget resolution was supposed to be an instrument of Congress to strengthen Congress, as you know President Reagan got control of the budget resolution and used it to advance Presidential White House objectives, particularly a military build-up and a few cuts on defense and tax cuts, and then deficits exploded.

David Stockman in his book—he was the OMB Director—said that Congress had to be reduced to a ministerial arm of the White House. Congress did not fight back during that time.

So those are my points. You have already mentioned—I will close with that—the difficulties that you pointed to on the board of a joint budget resolution. I would just add to some of the things you have there. Some people in the House worry that lack of germaneness in the Senate that, as you suggested, if a joint budget resolution is going through, people are going to be tempted to put on something that could not pass otherwise. And House Members are concerned about that, that they would find non-germane things put on in the Senate side, and Presidential power would be increased.

I will stop with that. Thank you very much.

[The prepared statement of Dr. Fisher follows:]

Statement by Louis Fisher,
The Constitution Project,
Before the
Senate Committee on the Budget,
"Improving the Congressional Budget Process"
October 12, 2011

Chairman Conrad, Ranking Member Sessions, and members of the committee. Thank you for inviting me to testify on legislation that would change the budget resolution to a joint budget resolution. The current process requires the adoption of a concurrent resolution, passed by both chambers but not submitted to the President. Although binding within Congress, it has no legal standing. To make it binding on both branches, legislation would convert the concurrent resolution to a joint resolution, to be forwarded to the President for signature or veto.

For reasons explained in this statement, I believe that further centralization of the congressional budget process would weaken Congress and do more harm than good. My judgment is formed partly from my experience with the Budget Act of 1974. I worked closely with the Senate Judiciary Committee on legislation to curb the President's power to withhold appropriated funds. I sat behind Senator Sam Ervin at hearings to provide professional assistance, participated in markup, wrote the part of the conference report dealing with impoundment, and even received a signing pen and letter from President Richard Nixon.[1] I fully supported this decision to limit impoundment and protect legislative powers.

Although I worked on other titles of the Budget Act of 1974, I had serious doubts about the need to centralize the legislative process by adopting a budget resolution. In following the debates over the years on a joint budget resolution, biennial budgeting, a presidential item veto, a balanced budget amendment, and other proposed reforms, I find that institutional and constitutional values are largely overlooked in the search for a more "effective" and "efficient" process. Reform proponents seem to think that if they keep adjusting the budget process, eventually they will get it right. I don't think so. Piecemeal reforms will not correct what is fundamentally wrong with the legislative assumptions of 1974. I will explain what I mean by that.

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[1] The impoundment battle in the early 1970s is covered in Louis Fisher, Defending Congress and the Constitution 205-11 (2011), http://www.kansaspress.ku.edu/fisdef.html.

I think the record is clear that that when Presidents submit a responsible budget with regard to aggregates (as required by the Budget and Accounting Act of 1921), Congress will live within those aggregates while changing the priorities, which it has every constitutional right to do. That process worked well before and it can work again. If the President submits an irresponsible budget on such aggregates as the deficit, which has been the pattern for many decades, lawmakers cannot correct it, regardless of the process. That is my fundamental point and I will develop it

1. Studying Reforms in a Constitutional Framework

The apparent appeal of a joint budget resolution is to change the legally non-binding concurrent resolution to a joint resolution, thus bringing the two branches together on a mutually agreed upon budget for the nation. No one doubts the failings of the current budget system. When President Ronald Reagan entered office in 1981, the national debt stood at one trillion dollars. It now exceeds 14 trillion with the prospect of much higher levels over the coming decade. The confidence of other nations in the capacity of the United States to manage its finances has declined. The principal issue is not whether the current budget process has serious failings. Demonstrably, it does. The more basic issue is how reform proposals will affect our constitutional system of government. I believe they will further weaken Congress, the system of representative government, separation of powers, checks and balances, and public trust in government.

2. The Missing Player: The President

For more than a century, Congress received from each administration an uncoordinated pile of agency budget requests. That process became intolerable after a string of deficits appeared at the end of the nineteenth century. To gain better control over the national budget, both branches worked on legislation that became the Budget and Accounting Act of 1921. It placed on the President a personal duty to have agency estimates carefully reviewed to produce a responsible national budget. The document that came from the administration was the *President's* budget. He sent it up and was responsible for it.

During debate on this statute, some budget reformers tried to weaken Congress by prohibiting lawmakers from appropriating any money unless it had been requested by the head of a department, or by a two-thirds vote, or to pay a claim against the government. All of those proposals, borrowing greatly from the British parliamentary system, were rejected. The President was empowered to present a budget, but thereafter it became a "legislative budget,"

enabling lawmakers to change it any way they wanted by simple majority vote. Congress refused to be subordinated to the President's budget.[2]

3. What Went Wrong?

Earlier I said that the total national debt, accumulated from 1789 to 1981, reached a trillion dollars when President Reagan took office. How did it get to 14 trillion and is still climbing? I think a large part of the answer lies with the Budget Act of 1974. The Nixon administration ridiculed lawmakers for their "hoary and traditional procedure" that permitted action on different spending programs "as if they were unrelated and independent actions."[3] Under this constant battering, Congress overreacted and failed to protect its institutional interests. This executive rhetoric, unleashed in the middle of the presidential campaign in 1972, had no statistical or evidentiary support.

From fiscal years 1969 through 1973, Congress reduced Nixon's appropriation requests by $30.9 billion. Over that same period, Congress increased spending authority on legislative bills (mandatory programs and backdoor spending) by $30.5 billion. In short, it was a wash. The decentralized system of Congress worked. The centralized system of the executive branch did not. Over a period of four years, Nixon's budgets added more than $100 billion to the national deficit.

4. The Lure of Centralization

Instead of rebuking President Nixon for submitting irresponsible budgets and making false statements about Congress and its legislative record, many lawmakers decided to turn against their own institution. They regularly apologized for the shortcomings of congressional procedures and promised to adopt a budget process that looked more like the executive branch. A congressional budget committee in 1973 linked budget deficits to procedural inadequacies within Congress. The fault, it said, was the decentralized nature of Congress and the failure "to arrive at congressional budget decisions on an overall basis."[4]

That critique was greatly overdrawn. The budget system of the early 1970s was not nearly so fragmented, incoherent, and irresponsible. The Joint Committee on Reduction of Federal Expenditures prepared "scorekeeping reports" and circulated them on a regular basis. This document, printed in the *Congressional Record*, informed lawmakers from month to month how congressional actions compared to the President's budget. The results revealed a systematic

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[2] H. Rept. No. 14, 67th Cong., 1st Sess. 6-7 (1921); 42 Stat. 20 (1921). Fisher, Defending Congress and the Constitution, at 202-04.
[3] Public Papers of the President, 1972, at 742.
[4] H. Rept. No. 147, 93d Cong., 1st Sess. 1 (1973).

and responsible pattern, not chaos. What was missing from the budget process was a responsible presidential budget, as mandated by the 1921 statute.

5. What Congress Got Right

The Budget Act of 1974 strengthened Congress in several ways. It established a new Congressional Budget Office (CBO) to provide much needed analytical support to lawmakers, making them less dependent on the executive branch. Over the years, CBO has earned a solid reputation by providing nonpartisan, professional assistance. In so doing, it has helped to protect the system of checks and balances and safeguard an independent legislative branch.[5] Title VII of the statute placed new duties on congressional committees and the General Accounting Office to evaluate federal programs. Title X put an end to presidential abuses through the impoundment process.

Title I established new House and Senate Budget Committees. These committees were authorized to make continuing studies of the national budget, including budget reform proposals. Each chamber of Congress now had a committee responsible for looking at the entire budget, covering appropriations, authorizations, revenues, tax expenditures, and credit policy.

6. Some "Reforms" Come Up Empty

Before discussing budget resolutions and joint budget resolutions, I want to comment on Title V of the 1974 statute, which moved the fiscal year from July 1 to October 1. Congress had been unable to complete action on appropriations bills and other legislation, leading to reliance on short-term funding through continuing resolutions. As explained by the House Committee on Rules, giving Congress three additional months to complete its workload would "put an end to the continuing resolution practice."[6] The Senate Committee on Government Operations predicted: "The October 1 date would enable Congress adequately to consider the budget within the existing congressional time frame." [7] The Senate Committee on Rules and Administration expressed confidence that Congress could complete its work with the additional three months.[8]

Of course the change in the fiscal year did not solve the problem of late appropriations and dependence on continuing resolutions. This reform is a good reminder that well intentioned changes may not produce the desired and expected results. A second example of a budget reform that did not deliver on its promises is the enactment of item-veto authority for the President in 1996, with the widely accepted belief that it would be a significant way to control spending and reduce deficits. Even before the Supreme Court declared the statute invalid in

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[5] Philip G. Joyce, The Congressional Budget Office: Honest Numbers, Power, and Policymaking (2011).
[6] H. Rept. No. 93-658, 93d Cong., 1st Sess. 31 (1973).
[7] S. Rept. No. 93-579, 93d Cong., 1st Sess. 62 (1973).
[8] S. Rept. No. 93-688, 93d Cong., 1st Sess. 62 (1973).

1998, the record was clear that the item veto had little effect on spending or deficits. In fact, there are good reasons why the availability of an item veto can *increase* spending.[9]

These cautionary tales about changing the fiscal year and enacting an item veto can be applied to other budget reform proposals, including the balanced budget amendment and biennial budgeting. I have testified a number of times on each proposal, pointing out why the promised benefits are not likely to materialize and why these changes could easily make things worse.[10]

7. Efforts to Centralize Congress

Supporters of the Budget Act of 1974 believed that if the executive budget of 1921 strengthened presidential control, as it did by creating the Bureau of the Budget (and its successor, the Office of Management and Budget), a legislative budget would strengthen Congress. I don't think the analogy holds. The two branches have different institutional qualities and capabilities. The President heads the executive branch and gains strength from a central budget office. There is no head in Congress and no possibility of a central budget office comparable to OMB. Executive agencies are subordinate to the control of the President and OMB. No such control could be exercised by CBO.

Compared to the executive branch, Congress is by nature decentralized. It is split between two chambers with rival political parties vying for control. The executive branch has two elected officials, the President and Vice President. Congress has 535, each with an independent political base. The legislative branch is driven by committees and subcommittees that operate with a certain level of autonomy. The executive branch is largely hierarchical. Congress is essentially collegial in its operations.

The relentless attacks on Congress by President Nixon and his executive officials took its toll. Lawmakers refused to defend their institution or their budget process. The 1974 statute assumed that lawmakers would behave more responsibly by having to vote explicitly on budget aggregates, facing up to totals rather than voting "piecemeal" on separate authorization, appropriation, and revenue bills. In 1974, "fragmentation," "splintering," and "decentralization" within the legislative branch were bad words. Reformers seemed to take the high road by speaking about "coordination" and a "unified budget process," even when those words were impossible for anyone to understand, much less predict their consequences.

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[9] Fisher, Defending Congress and the Constitution, at 218-24, 229-31.
[10] Id. at 224-28.

8. The Experience with Budget Resolutions

It was not difficult to understand that the 1974 statute carried substantial costs for budget accountability and control. First, it weakened a central purpose of the Budget and Accounting Act of 1921: the personal and nondelegable duty of the President to prepare a responsible budget. The President had a statutory duty to get the budget off to a reasonable start. After 1974, there would be multiple budgets: one submitted by the President, the House budget resolution, the Senate budget resolution, and the final budget resolution agreed to by both houses.

Until 1974, the President's budget provided a fixed and visible benchmark. It was easy for lawmakers and the public to know when congressional action was above or below the President's recommendations. That reference point now disappeared. Instead of keeping within the President's aggregates, members of Congress could vote on generous ceilings in budget resolutions and tell their constituents (and themselves) that they had "stayed within the budget," even if their actions exceeded the President's budget.[11] President Reagan was more than willing to step aside and let Congress make the budget. The new statutory process offered Presidents many advantages. In 1985, he announced his acceptance of appropriation bills "even if above my budget, that were within the limits set by Congress's own budget resolution."[12]

Second, the 1974 statute weakened the Appropriations Committees, which had performed the role of fiscal guardian. It was their assigned task to keep appropriations under the President's request. The budget resolution made that institutional purpose far more difficult. If their draft bill fell below the amount allocated to them in a budget resolution, lawmakers would offer amendments to bring the bill "up to" the figure in the budget resolution.[13]

Third, if Presidents ducked their statutory duty under the 1921 law by sending up irresponsible budgets and tossing the problem to Congress and its new process, lawmakers had no capacity to convert an irresponsible budget to a responsible one. Suppose President Reagan submitted a budget with a deficit of several hundred billion. How could Congress remedy that? Lawmakers would have to drastically cut spending and radically increase taxes. Politically they could not do that.

By 1985, the failures of the new budget process were in full view. Even though the procedures were designed to handle such aggregates as total spending, total revenues, and deficits, it was quickly recognized that the process could not manage the deficits of Reagan's

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[11] 122 Cong. Rec. 17843 (1976), statement by Rep. Tom Steed; 129 Cong. Rec. 25417 (1983), statement by Rep. Jim Wright. See Fisher, Defending Congress and the Constitution, at 211-12.

[12] Public Papers of the Presidents, 1985, II, at 1401.

[13] Allen Schick, Congress and Money: Budgeting, Spending, and Taxing 313 (1980). See also Joel Havemann, Congress and the Budget 152-53 (1978), and 125 Cong. Rec. 9028 (1979), statement by Rep. Bob Giaimo.

budgets. Consequently, Congress experimented with the hapless Gramm-Rudman Act, which offered a schedule to gradually reduce deficits until they reached zero. The statute was spectacularly ineffective, leading to Gramm-Rudman II, which also failed to control deficits.[14]

9. How the Budget Act Backfired

Most budget reformers in 1974 assumed that centralization is better than decentralization, comprehensive plans are superior to fragmentation, and larger legislative vehicles (budget resolutions) naturally excel over smaller ones. The objective: use centralizing forces within Congress to strengthen the legislative branch and weaken the President. The opposite result occurred in 1981 when President Reagan gained control of the budget resolution by attracting Republicans and conservative Democrats. He used the budget resolution as a blueprint to cut taxes, increase defense spending, and reduce some domestic programs. By seizing control of the budget resolution and the reconciliation process, he could largely control appropriations bills and the tax bill. The budget resolution advanced presidential, not congressional, objectives. Instead of the annual deficits of $25 billion that plagued the Nixon years, deficits exploded to $200 billion a year.

It is highly unlikely that the costly political and economic miscalculations of 1981 could have occurred without budget resolutions and the reconciliation process. President Reagan would have faced almost insurmountable hurdles had to tried to push his economic program through a decentralized Congress, with committees and subcommittees able to check and reshape White House objectives. Incremental legislative actions present an effective brake on presidential ambitions.[15]

David Stockman, who headed OMB from 1981 to 1985, explained how the Reagan administration exploited the centralized congressional process. The constitutional prerogatives of Congress "would have to be, in effect, suspended. Enacting the Reagan administration's economic program meant rubber stamp approval, nothing less. The world's greatest deliberative body would have to be reduced to the status of a ministerial arm of the White House."[16] Members of Congress, far more expert in budget matters than Stockman, regularly deferred to his leadership, assertions, and analysis. After leaving office, Stockman admitted his lack of understanding: "[A] plan for radical and abrupt change required deep comprehension – and we had none of it."[17]

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[14] Fisher, Defending Congress and the Constitution, at 213-17.

[15] Rudolph G. Penner, "An Appraisal of the Congressional Budget Process," in Crisis in the Budget Process 69 (1986); Allen Schick, "How the Budget Was Won and Lost," In Norman J. Ornstein, ed., President and Congress: Assessing Reagan's First Year 25 (1982).

[16] David A. Stockman, The Triumph of Politics: How the Reagan Revolution Failed 59 (1986).

[17] Id. at 91.

10. Joint Budget Resolutions

Congress has considered the merits of a joint budget resolution. The Comprehensive Budget Process Reform Act of 1999 stated these purposes of a joint budget resolution: to "focus initial budgetary deliberations on aggregate levels of Federal spending and taxation; encourage cooperation between Congress and the President in developing overall budgetary priorities; and reach budgetary decisions early in the legislative cycle."[18] If the two branches failed to agree, a fall-back procedure was available: a concurrent resolution passed under expedited procedures.[19] Members who opposed this reform warned that a joint budget resolution "starts us on a slippery downhill slope." Once the President and congressional leaders began negotiating over a real statute, not a planning document (as with a concurrent resolution), "they may succumb to the temptation to directly legislate, or statutorily mandate, the fruits of their negotiation." If that happened, "the power over major budgetary details will slip away from the committees and the individual Members and gravitate toward the President and the Leadership."[20]

How would the two branches negotiate on a joint budget resolution? Which members of Congress would be invited to participate? Members recalled one set of negotiations "at Andrews Air Force Base between the Congress and the President scrambling, with sometimes only three people in the room."[21] To Rep. David Obey, a joint budget resolution would put the President "right in the middle of Congress' obligation to define its own budget resolution. So the President gets two kicks at the cat: once when he submits his budget and then another when he puts together a huge budget summit out at Andrews or some other place like they have been in the past, and the President will come to totally dominate that debate. And every rank and file Member of this place will be on the outside looking in, passing notes in, hoping that a handful of people on the inside will give them an occasional listen. We do not want to do that."[22]

Rep. Obey also discussed how a joint budget resolution would affect the relationship between the House and the Senate. He concluded it would "enhance the power of the Senate vis-à-vis the House." Because the Senate operates on unanimous consent and a system of holds, the Senate leadership would be vulnerable to having a Senate chairman insist: "I'm not going to vote for your budget resolution unless you add my authorization bill in the budget resolution." Other Senators would be motivated to add legislative language to a joint budget resolution. Obey pointed to another difference between the House and the Senate: "we have a germaneness rule, but in the Senate there is no germaneness rule. And so they can add virtually anything they want."[23]

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[18] H. Rept. No. 198 (Part 2), 106th Cong., 1st Sess. 3 (1999).
[19] Id. at 5-6, 29, 36.
[20] Id. at 202.
[21] 146 Cong. Rec. H3086 (daily ed. May 16, 2000), statement by Rep. Jim Nussle.
[22] Id. at H3088.
[23] Id.

In 1999, some members of the House Committee on Rules pointed to other problems of a joint budget resolution. It would make "it more difficult to agree on a budget." It is "hard enough to adopt a congressional budget resolution on time . . . . Asking the President to sign it will only make it more difficult to come to a quick agreement."[24] Speaking during floor debate the next year, Rep. Joe Moakley warned that a joint budget resolution "will stall the appropriations process even further, while Congress and the White House struggle and struggle to agree."[25]

Rep. Obey pointed out that if Congress were to pass a joint budget resolution and discovered it did not work as intended and wanted to repeal or revise it, "we will not be able to change it without the permission of the President of the United States. That is not a position which any independent legislative body should be in."[26]

11. Rediscovering What Worked

Ever since the Budget Act of 1974 there has been a move toward greater centralization of Congress, leading to the passage of a budget resolution and now the possible shift to a joint budget resolution. On paper the budget process appeared to look more comprehensive and formal, implying greater coherence and responsibility. But what have been the results? Less budget control and higher deficits. In hearings in 1990, former CBO Director Rudolph Penner called attention to this interesting pattern. Prior to 1974, budget issues were handled reasonably well under the regular, "fragmented" political process, disorderly as it might have appeared. Budget resolutions were widely praised because they represented a vehicle for centralized, systematic, and comprehensive legislative action.

Penner, however, made this observation: "I have always been struck by the fact in looking at the history of the [budget] process that it appeared chaotic in the late 19th century and early 20th century, but the results were very good in terms of budget discipline, yielding balanced budgets or surpluses most of the time, unless there was really a good reason to run a deficit." The budget process created in 1974 "looks very elegant on paper, but it is leading to very dishonest and disorderly results." He admitted that he was "one of those public policy analysts who thought the 1974 process was a good idea when it was first invented. I have to confess to a lot of disappointment and frustration as to how it actually worked out. I think the criticism of that process, that it was too complex and too time consuming, are right on the mark."[27]

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[24] H. Rept. No. 198 (Part 3), 106th Cong., 1st Sess. 163 (1999).
[25] 146 Cong. Rec. H3085 (daily ed. May 16, 2000).
[26] Id. at H3105.
[27] "Budget Process Reform," hearing before the House Committee on the Budget, 101st Cong., 2d Sess. 20-21 (1990).

If we agree that the budget process established in 1974 created dramatically less control over spending and deficits, what can be done to recreate what worked better in the past? First: restore the essential importance of a responsible presidential budget. There must be pressure on the President – from Congress, scholars, interest groups, the public, and the media – to assure that the process begins with accountability for getting aggregates in order, particularly deficits. *Executive leadership is needed when submitting a responsible budget, not at some later point.* Congress can then live basically within those aggregates and change priorities as it likes.

We need a visible, credible, and accountable presidential budget. The political focus must be on the President, where it was before 1974 and where it needs to be now. With one budget, the nation can fix a spotlight on the President and restore needed accountability and personal responsibility.

BIOSKETCH FOR LOUIS FISHER

Louis Fisher is Scholar in Residence at the Constitution Project. Previously he worked for four decades at the Library of Congress as Senior Specialist in Separation of Powers (Congressional Research Service, from 1970 to 1996) and Specialist in Constitutional Law (the Law Library, from 2006 to 2010). During his service with CRS he was research director of the House Iran-Contra Committee in 1987, writing major sections of the final report.

His books include *President and Congress* (1972), *Presidential Spending Power* (1975), *The Constitution Between Friends* (1978), *The Politics of Shared Power* (4th ed. 1998), *Constitutional Conflicts Between Congress and the President* (5th ed. 2007), *Constitutional Dialogues* (1988), *American Constitutional Law* (with Katy J. Harriger, 9th ed. 2011), *Presidential War Power* (2d ed. 2004), *Political Dynamics of Constitutional Law* (with Neal Devins, 4th ed. 2006), *Congressional Abdication on War and Spending* (2000), *Religious Liberty in America: Political Safeguards* (2002), *Nazi Saboteurs on Trial: A Military Tribunal & American Law* (2003; 2d ed. 2005), *The Politics of Executive Privilege* (2004), *The Democratic Constitution* (with Neal Devins, 2004), *Military Tribunals and Presidential Power: American Revolution to the War on Terrorism* (2005), In the *Name of National Security: Unchecked Presidential Power and the* Reynolds *Case* (2006), *The Constitution and 9/11: Recurring Threats to America's Freedoms* (2008), *The Supreme Court and Congress: Rival Interpretations* (2009), *On Appreciating Congress: The People's Branch* (2010), and *Defending Congress and the Constitution* (2011). His textbook in constitutional law is available in two paperbacks: *Constitutional Structures: Separation of Powers and Federalism* and *Constitutional Rights: Civil Rights and Civil Liberties*. With Leonard W. Levy he edited the four-volume *Encyclopedia of the American Presidency* (1994). He has twice won the Louis Brownlow Book Award (for *Presidential Spending Power* and *Constitutional Dialogues*). The encyclopedia he co-edited was awarded the Dartmouth Medal. In 1995 he received the Aaron B. Wildavsky Award "For Lifetime Scholarly Achievement in Public Budgeting" from the Association for Budgeting and Financial Management. In 2006 he received the Neustadt Book Award for *Military Tribunals and Presidential Power*. In 2011 he received the Walter Beach Pi Sigma Alpha Award from the National Capital Area Political Science Association for strengthening the relationship between political science and public service.

He received his doctorate in political science from the New School for Social Research (1967) and has taught at Queens College, Georgetown University, American University, Catholic University, Indiana University, Johns Hopkins University, the College of William and Mary law school, and the Catholic University law school.

Dr. Fisher has been invited to testify before Congress more than 50 times on such issues as war powers, state secrets privilege, NSA surveillance, executive spending discretion, presidential reorganization authority, Congress and the Constitution, the legislative veto, the item veto, the Gramm-Rudman deficit control act, executive privilege, committee subpoenas, executive lobbying, CIA whistleblowing, covert spending, the pocket veto, recess appointments, the budget process, the balanced budget amendment, biennial budgeting, and presidential impoundment powers.

He has been active with CEELI (Central and East European Law Initiative) of the American Bar Association, traveling to Bulgaria, Albania, and Hungary to assist constitution-writers, participating in CEELI conferences in Washington, D.C. with delegations from Bosnia-Herzegovina, Lithuania, Romania, and Russia, serving on CEELI "working groups" on Armenia and Belarus, and assisting in constitutional amendments for the Kyrgyz Republic. As part of CRS delegations he traveled to Russia and Ukraine to assist on constitutional questions. For the International Bar Association he helped analyze the draft constitutions for Swaziland and Zimbabwe.

Dr. Fisher's specialties include constitutional law, war powers, budget policy, executive-legislative relations, and judicial-congressional relations. He is the author of more than 400 articles in law reviews, political science journals, encyclopedias, books, magazines, and newspapers. He has been invited to speak in Albania, Australia, Belgium, Bulgaria, Canada, China, the Czech Republic, Denmark, England, France, Germany, Greece, Israel, Japan, Macedonia, Malaysia, Mexico, the Netherlands, Oman, the Philippines, Poland, Romania, Russia, Slovenia, South Korea, Sweden, Taiwan, Ukraine, and the United Arab Emirates.

Chairman CONRAD. Thank you.

Dr. Joyce is the professor of management, finance, and leadership at the University of Maryland School of Public Policy. Good to have you here.

STATEMENT OF PHILIP G. JOYCE, PH.D., PROFESSOR OF MANAGEMENT, FINANCE, AND LEADERSHIP, SCHOOL OF PUBLIC POLICY, UNIVERSITY OF MARYLAND

Dr. JOYCE. Thank you. I am happy to be here, Chairman Conrad, Ranking Member Sessions. I am happy to be here to talk about ways that the budget process could be made more effective. I want to say I am heavily influenced in these views by having spent 5 years at CBO in the early 1990s when my mission in life was following various ideas that Members of Congress had for reforming the budget process, and I used to say there were as many ideas as there were Members of Congress. And I think it is useful to spend some time thinking about the implications of those reform ideas.

I also developed over that time a deep respect for the Senate Budget Committee and your colleagues on the House Budget Committee, who I think have a very difficult job, which is trying to take what Dr. Fisher correctly points out is a sort of decentralized process and try to centralize it in some way.

I will not go into, because Dr. Fisher did a very good job of it, the reasons for the 1974 Budget Act. I think you are all well aware of that. I will say that actual experience with the 1974 Budget Act has been a little more checkered than the Framers might have hoped, and I think there are three problems that stand out, none of which are a revelation to this Committee.

First, the Congress has fallen into a pattern where the budget resolution is viewed as optional. There have been six times in the last 14 years—and I am including this year—that there has been no budget resolution at all. That is 40 percent of the time.

Second, while during the 1990s the budget resolution was used to promote fiscal discipline, in a few notable cases since 2001 it has been used more often to make deficits larger.

And, third, even when the budget resolution was used to impose fiscal discipline through the reconciliation process, this was often followed by committees trying to undo those actions later on.

No institutional or process change is going to get us out of the mess that we are in right now. That is going to require hard policy choices to increase revenue and decrease spending. Process changes, though, might facilitate a more functional congressional budget process once we get past this point, and it is within this context that I think the proposed change to convert the budget resolution into a joint resolution should be considered.

In considering the pros and cons of this change, I would like to focus on three possible effects: one of them is on institutional power and relationships; the second is on the timeliness and efficiency of the process; and the third is on fiscal discipline.

In terms of institutional power and relationships, proponents of the change argue that a joint budget resolution would facilitate agreement between the President and the Congress early in the budget process. I am concerned that requiring the budget resolution to have the President's signature tilts the balance of power too

far toward the President. The Budget Act of 1974 made the Congress a more equal player in the budget process. The Congress is not an equal player if the President can propose his budget and then subsequently veto the budget resolution if it is not consistent with his own budget. My advice would be that advocates of more Presidential power—not only in this case but in other cases like the line-item veto—are wise to contemplate the implications of that power being exercised not by an executive they agree with, but by an executive whose policies they strongly oppose.

In terms of timeliness and efficiency, I think the real question is whether a joint resolution makes adoption of the budget resolution more likely to occur and more likely to occur in a timely manner. My bottom line is I do not think so. In years in which the President and the Congress are inclined to agree with each other on the outlines of the budget, I do not think requiring the President's formal approval is going to change much.

During periods of unified Government—and unified Government is what we have had during 8 of the 37 years since 1975—a joint budget resolution I think would be unlikely to influence timeliness of the budget process one way or another.

Alternatively, though, if the President and the Congress do not agree even on the broad outlines of policy—and I think that typically would describe a period of divided Government—the requirement for a joint budget resolution might stop the budget process dead in its tracks. A joint budget resolution simply front-loads conflicts, increasing chances that the budget resolution is going to be either delayed or precluded. This is a problem we already have, and I think it would be made worse by requiring a joint resolution.

Now, I do think the likelihood of failure could be addressed, at least in part, by some kind of fallback provision like the ones that the Chairman had outlined earlier.

What about fiscal discipline? Well, I think I agree with Dr. Fisher that one lesson that has emerged out of the last 37 years of congressional budgets is that Presidents tend to drive budgetary agendas. A further lesson is that the Congress is unlikely to lead if inflicting budgetary pain is involved. This seems to suggest to me that if a President cared about fiscal discipline, a joint budget resolution would make it easier for the President to get Congress to go along with him. On the other hand, though, if a President or a Congress desired policies that would not reduce deficits but expand them, having a joint budget resolution would also make that easier.

For example, the discretionary spending caps that were just enacted as part of the Budget Control Act could not be changed by a concurrent resolution on the budget, but could be changed by a joint budget resolution. And there would also be great pressure to change other laws as part of the budget resolution, particularly if the budget resolution was seen as must-pass legislation.

I have some additional observations in my testimony about likely effectiveness of other proposed changes, that is, changes that might support or promote enactment of the budget resolution. I will not cover them in any detail now in the interest of time. I am happy to answer questions about them.

I would like to note, though, that one suggested reform would change the membership of the Budget Committees to reflect the

leadership of the Congress by putting Chairs and Ranking Members of other committees on the Budget Committees, and this is a proposal that goes back at least as far as a proposal by Senator Kassebaum in the late 1980s to create something that she called a "Committee on National Priorities," which really would serve the same function that the Budget Committee has been serving.

The justifying argument for this is that if the congressional leadership had more incentive to make the budget resolution meaningful, it might enhance its likelihood of passage and it would be more likely that other committees would follow it since those committees would have representation on the Budget Committees.

In addition to membership changes, there are other changes you might consider, other sanctions and other incentives that might make it more likely that budget resolutions would pass and be followed.

In conclusion, I once heard a colleague observe, in response to a question about the messiness of the Federal budget process, that, "Monarchy budgeting is easy." If it worked well, the process encouraged by a joint budget resolution would improve fiscal discipline and the timeliness of the process. I am concerned, however, that more frequently it would not work well and that the relatively limited advantages would come with too large a cost in terms of enhancing Presidential power. So it seems to me to be more fruitful to determine what other incentives of the kind that the Chairman had talked about in his opening statement might promote more effective functioning of the concurrent resolution process that you already have.

Thank you very much.

[The prepared statement of Dr. Joyce follows:]

Statement of

Philip G. Joyce

Professor of Management, Finance and Leadership

University of Maryland, School of Public Policy

Before

Committee on the Budget

United States Senate

October 12, 2011

On "Improving the Congressional Budget Process"

Chairman Conrad, Ranking Member Sessions and Members of the Committee:

I am pleased to be here today to talk to you about ways in which the budget resolution could be made more effective. This is an important topic, as I believe the country needs a strong Congressional budget process, and this means an effective budget resolution and Budget Committees. My testimony will cover two main topics. First I will discuss a specific reform of interest to many members of this committee, which is making the budget resolution into a joint resolution, requiring the President's signature. Second, I will address other possible institutional changes and sanctions that might make it more likely that the budget resolution would be successful in meeting its original aims under the Congressional Budget and Impoundment Control Act of 1974.

Historical Background

Before moving on to considering specific reforms, it may be useful to remind ourselves of the historical context in which the budget resolution was established. The Congressional Budget and Impoundment Control Act of 1974 intended to coordinate budgeting decision-making in Congress as it never had been before. The theory behind this coordination was that the budget resolution would allow Congress to set overall fiscal policy and adhere to fiscal discipline. The Budget Committees, created to manage the budget resolution, were charged with being the guardians of overall fiscal policy in Congress. Further, and this seems particularly important to remember in the context of the issues under consideration today, the 1974 budget reform was intended to strengthen the role of the Congress in the budget process, particularly in the face of expansions of presidential power.

After some early growing pains, the budget resolution clearly established itself as the means by which Congress decided on overall fiscal policy. Moreover, it represented an important vehicle through which Congress, when it wanted to (or was encouraged by the president) enacted legislation to enhance fiscal responsibility, mainly through the use of the budget resolution's reconciliation procedures. Reconciliation was front and center when important deficit-reducing legislation was passed and signed into law in 1990, 1993, and 1997. More recently, however, the budget resolution process has become dysfunctional. Three problems stand out:

- Congress has fallen into a pattern where the budget resolution is viewed as optional. This is a striking departure from past practice. From the advent of the budget resolution in fiscal year 1977 through fiscal year 1998 (that is, the first 22 years), there was *always* a budget resolution, although these resolutions were frequently late. Since fiscal year 1999, however (a span of 14 years, including this year), on *six* separate occasions (that is, more than 40 percent of the time) Congress has failed to adopt a budget resolution at all. This represents not only a failure of Congress generally, but suggests that the

Budget Committees lack the clout that is necessary to treat the budget resolution as the imperative that it should be.

- While the budget resolution was used to impose or promote fiscal discipline in a few notable cases, especially during the 1990s, it has since 2001 been used to make deficits larger.

- Even when the budget resolution was used to impose fiscal discipline on other committees in Congress through the use of the reconciliation process, this was usually done without much enthusiastic support from these other committees. Deficit-reducing actions in one year might have been followed by attempts to undo this deficit reduction in subsequent years.

Numerous commissions and independent groups have highlighted the need for the country to confront both medium- and long-term federal budgetary challenges.[1] In the context of doing so, it is vitally important for Congress to have a budget process—and budget institutions—that can foster the kind of decisions that will enable the country to meet those challenges. The budget resolution, in its current incarnation, seems not up to this task. If it is to work effectively, the Budget Committees should be able to lead other committees to take deficit-reducing actions that are contrary to the immediate political interest of committee members and their constituents.

No institutional or process change will stabilize the debt. That will require hard policy choices to increase revenue and decrease spending. Process changes might, however, make the Congressional budget process more functional once we have reached a point where the debt has been stabilized. The purpose of considering a reform of the budget resolution or Budget Committees is to determine whether they might, going forward, be more institutionally capable of realizing the promise envisioned by the 1974 budget reform that created them.

Would a Joint Budget Resolution Improve Things?

At present, the budget resolution is a concurrent resolution, which means it represents a set of rules designed to guide congressional action, but does not require the president's signature. The main argument for a *joint* budget resolution (JBR), which would require the president to agree, is that it would facilitate negotiations between the president and Congress early in the budget process, at

[1] These include the President's Deficit Commission, the Bipartisan Policy Center, and the Peterson-Pew Commission on Budget Reform. For an example of recommendations focusing on the budget process, see Peterson-Pew Commission on Budget Reform, Red Ink Rising (Peterson-Pew Commission on Budget Reform, 2009); Peterson-Pew Commission on Budget Reform, Getting Back in the Black (Peterson-Pew Commission on Budget Reform, 2010).

least on broad outlines of the budget. This would be a positive event if it occurred.[2] Further, in our system, presidents have tended to be the actors in our system in the best institutional position to lead.[3] There are some examples (in 1990 and 1993) of deficit reduction heavily influenced by a presidential decision to pursue fiscal discipline, thus there is some appeal in the notion that involving presidents earlier would promote responsible budgeting. For a joint budget resolution to work, it requires negotiation up front on the broad outlines of a policy that promotes fiscal discipline, and then follow-through by committees that translate this broad outline into specific policies to realize the budget resolution.

In considering the pros and cons of the joint budget resolution, I would like to focus on the effects that the reform might have on three things:

- institutional power and relationships;
- the timeliness and efficiency of the process; and
- fiscal discipline.

Institutional Power and Relationships. According to proponents, a joint budget resolution would facilitate agreement between the President and the Congress early in the budget process, at least on the big picture. Presently, the President has no formal role, and no formal means for preventing the Congress from enacting a budget different from his own proposal, until appropriation bills and other substantive legislation reach his desk. Under a joint budget resolution, the Congress would not be prevented from sending the President a budget not to his liking. However, any President faced with such an outcome would almost certainly veto that legislation. The net result of such a presidential veto would be that the President's budget would stand as the only unified statement of national priorities. This would represent a return to conditions that prevailed prior to the 1974 Budget Act.

I am concerned that requiring the budget resolution to have the President's signature tilts the balance of budgetary power too far toward the President. For better or worse (and I think better) the Budget Act of 1974 made the Congress a more equal player in the budget process. The Congress is NOT an equal player if the President can propose a budget, and subsequently veto the budget resolution if it is not consistent with his own budget. It is obviously up to you and your colleagues whether you want to go back to a time where the President is clearly ascendant. My advice, however, is that advocates of more Presidential power would be wise to contemplate the implications of increased Presidential power being exercised not by

[2] Roy Meyers, "The Budget Resolution Should be a Law," *Public Budgeting & Finance* 10, Number 3 (Fall 1990), pp. 103-112.
[3] Louis Fisher, "Federal Budget Doldrums: The Vacuum in Presidential Leadership," *Public Administration Review* 50 (1990), 693-700.

an executive whose policies they embrace – but one whose policies they strongly oppose.

Timeliness and Efficiency. The adoption of the budget resolution, a given from 1975 to 1998, has become a hit and miss proposition. If a joint budget resolution worked as advertised, it would improve the timeliness of the process by facilitating agreement earlier in the Congressional session. Earlier agreement between the President and Congress is undoubtedly a desirable outcome.

The real question is whether a joint resolution makes adoption of the budget resolution in a timely manner more likely to occur. I don't think so. In years in which the President and the Congress are inclined to agree with each other on the outlines of the budget, I don't think requiring the President's formal approval will change much. To state what is undoubtedly obvious, history demonstrates that periods of unified government are much more likely to result in agreement between the President and Congress than periods of divided government. During periods of unified government (that would represent 8 of the 37 years between 1975 and 2011), therefore, a joint budget resolution would be unlikely to influence timeliness of the budget process, in either direction.

Alternatively, if the President and the Congress do not agree on even the broad outlines of policy (as seems likely during periods of divided government—the other 29 years since 1975), requirement for a joint budget resolution could stop the budget process dead in its tracks. To the extent policy and priority conflicts define Presidential-Congressional relations, a joint budget resolution would simply front-load those conflicts, increasing chances that the budget resolution would be delayed, or worse, precluded. The net outcome would be that a problem of relatively recent vintage (failure to agree on a concurrent resolution) would be exacerbated – and institutionally enshrined – by requiring a joint resolution. The probability that the process could be halted by the failure to gain the President's agreement is lessened by the provision in some joint budget resolution proposals for a concurrent resolution as a fallback should the joint resolution process fail.

The bottom line is that I do not believe that a joint resolution itself would improve the timeliness of the process. In years in which the President and the Congress agree, current informal communications accomplish what is necessary. In years in which agreement eludes the branches, Presidential involvement would be far more likely to slow the budget process, not render it more timely.

Fiscal Discipline. One lesson emerging out of the past 37 years of Congressional budgeting is that Presidents tend to drive budgetary agendas. A further lesson is that the Congress is unlikely to lead if inflicting budgetary pain is involved. This seems to suggest that if a President cared about fiscal discipline (like the first President Bush or President Clinton), a joint budget resolution would make it easier for that President to move the Congress in the same direction. If, on the other hand, a President desired policies that would likely expand deficits (such as President

Reagan, the second President Bush, or even President Obama), having a joint budget resolution would also make that easier. On this last point, it is worth noting that neither President Reagan nor the second President Bush seemed to have any trouble enacting policies increasing the deficit, even WITHOUT a joint budget resolution.

Absence of unequivocal benefits notwithstanding, I do think a joint budget resolution with the force of law might strengthen enforcement in narrow circumstances. Enhanced enforcement would facilitate adherence to the budget resolution in consideration of subsequent legislation. Thus, in cases where the joint budget resolution was used as a tool of fiscal discipline, it would make that discipline easier to achieve.

On the other hand, the budget resolution could also be used in a way that compromised fiscal discipline. For example, the discretionary spending caps that were just enacted as part of the Budget Control Act of 2011 could not be changed by a concurrent resolution on the budget. If the budget resolution was a joint resolution, however, these and other budget enforcement procedures could be changed annually as part of the budget resolution process. Moreover, there would be great pressure to change law as part of the budget resolution, particularly if it were seen as "must pass" legislation. This means that the budget resolution might attract many legislative proposals, at least some of which (based on historical precedent) would add to deficits.

A joint budget resolution, therefore, could either enhance or detract from fiscal discipline, depending largely on the underlying goals of the Congress and President. It would likely improve it *only* at times when commitment already existed to moving the country in that direction.

Conclusion. In responding to a question about the messiness of the federal budget process, I once heard a colleague reply: "Monarchy budgeting is easy". The framers of the 1974 Budget Act, I believe, were fundamentally on target in their desire to push back against executive power. They devised a concurrent budget resolution to give the Congress an opportunity to formulate a budgetary agenda that would compete with the budgetary vision articulated in the President's budget. I think that, if it worked well, a joint budget resolution could improve fiscal discipline and the timeliness of the process. I am, concerned, however, that more frequently it would not work well, and that relatively limited advantages would come with too large a cost in terms of enhancing Presidential power. I am not yet ready to advocate enacting a reform that will give Presidents—who tend to be willing to augment the power of the office, especially in recent years—more leverage in the budget process.

<u>What Other Changes Might Make the Budget Resolution More Effective?</u>

In addition to the possibility of a joint budget resolution there are other changes that might be made to either increase the odds that the budget resolution would be enacted and enforced to begin with, or that it would be followed once it was enacted. I will emphasize a particular reform that I have spent some time examining, which involves changing incentives by changing the membership of the Budget Committees themselves.[4] I will follow this with a brief discussion of other sanctions and incentives that might be used to encourage Congress to use the budget process in the way in which it was intended.

Changing the Membership of the Budget Committees. Some people have suggested that it might be possible to increase the odds of the budget resolution being adopted and followed if the Budget Committee membership was more reflective of the leadership of the Congress.

Starting in 1987, Kansas Senator Nancy Landon Kassebaum introduced a resolution (applying to the Senate only) that would have created leadership committees in the Senate to replace the Budget Committees. The Kassebaum proposal would have created a Senate Committee on National Priorities, with responsibility for drafting the annual budget resolution, which would then still need to be passed by the whole Senate. Senator Kassebaum proposed that this committee consist of the chairs and ranking members of all Senate committees, except that the majority leader of the Senate would have had the authority to appoint up to five additional senators to serve on this committee in order to make its membership mirror the relative balance between the majority and minority parties in the Senate (some versions of this idea envision an identical number of Republicans and Democrats on the committee). This proposed legislation would also have abolished the Appropriations Committee by combining authorizations and appropriations into single committees by substantive area.

The second report of the Peterson-Pew Commission on Budget Reform, *Getting Back in the Black,* explicitly embraced a change in Budget Committee membership as a part of a broader set of reforms designed to develop a multi-year plan to achieve budget targets. Ultimately, the Budget Committees would include "House and Senate leaders and the chairs and ranking members of both the appropriations and revenue committees and other major authorizing committees".[5] This recommendation would clearly be targeted toward making it more likely that the Budget Committees would be invested in the fiscal goals that had been agreed to and would be committed to carrying out those goals in the subsequent legislation that would be crafted.

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[4] For more details, see Philip Joyce, *Strengthening the Budget Committees: Institutional Reforms to Promote Fiscally Responsible Budgeting in Congress* (Pew Charitable Trusts 2011).

[5] Peterson-Pew Commission on Budget Reform, *Getting Back in the Black.*

In considering the possible changes that might result from changing Budget Committee membership in this way, we return to three problems with the current budget resolution discussed earlier—budget resolution adoption, fiscal responsibility, and committee buy-in to the budget process.

1. Would reforming Budget Committee membership make it more likely Congress would adopt a budget resolution every year? If congressional leaders, including committee chairs and ranking members, are on the Budget Committees, a potential additional imperative for consideration and passage might occur. *That is, if the resolution was explicitly a responsibility of the leadership, the failure to adopt might be seen as an explicit failure of the congressional leadership.* This would presumably carry greater political weight than the failure of one of the Budget Committees to pass a budget resolution does at present. There would be a downside to this, not the least of which would be a decline, because of time constraints, in the capacity of the Budget Committees to hold hearings on behalf of Congress to inform future fiscal policy and educate both Congress and the public. It seems more likely that the Budget Committees would gear up when there was significant legislation being considered, but otherwise would be dormant.

2. Would the reform make it more likely that a budget resolution would take a fiscally responsible stance? Historically, fiscally responsible budget resolutions—as those adopted in 1990, 1993, and 1997—occur as a result of presidential and congressional leadership, leading to cooperation between the two branches. Fiscal responsibility usually involves taking away benefits from people who do not want to lose them or imposing taxes on people who do not want to pay them. It seems essential that it begin with an agreed-upon fiscal goal.[6] Absent agreement on a goal and the commitment of the president and congressional leaders to achieving it, it is folly to expect that the Budget Committees, however constituted, can force Congress and the president to adopt a fiscally responsible stance. Thus the crucial, preceding step is agreement on this goal. Once the goal is agreed upon, it is presumed that the president and Congress will feel politically pressured to adopt budget policies that are consistent with that path. This is not necessarily related to the Budget Committee membership model chosen.

3. Would reform of the Budget Committees make it more likely that those whose legislative assent is necessary would support reconciliation instructions to reduce the deficit? From the beginning, the congressional budget process has been notable for the tension that it has created between the Budget Committees and other committees in Congress. This was initially reflected in an effort to keep the Budget Committees relatively weak. Initially, in fact, the Budget Committees were seen by some of the early 1970s budget reformers as little more than extensions of the

[6] The Peterson-Pew Commission on Budget Reform, in its Getting Back in the Black report (2010) suggested a goal of stabilizing the debt at 60 percent of GDP.

appropriations and tax-writing committees. As the membership of the Budget Committees expanded to include more junior members and those from committees other than Finance, Ways and Means and Appropriations, this carried with it increased inter-committee tension. This tension is particularly evident in reconciliation, where the budget resolution sets targets and provides instructions to authorizing committees, which need to follow these instructions in good faith in order to promote a fiscally responsible path.

For the Budget Committees to work as intended, they must convince other committees to go along with an overall vision for the budget, as defined by the budget resolution and reconciliation. By explicitly including the chairs and ranking members of appropriate committees as members of the Budget Committees, these members would presumably have ownership of the budget resolution, which would make them more likely to take seriously the necessity to go along with it. In addition, the leadership would be held accountable for overall fiscal outcomes to a greater extent than is currently the case, since they will have a clear responsibility for the resolution.

Perhaps the most important point is this: Regardless of whether the resolution itself is more likely to be adopted under this new structure, *or* whether it is more likely to be fiscally responsible, the inclusion of the leadership on the Budget Committees is likely to smooth the translation of the budget resolution targets into the necessary legislation to meet those targets, *and* to promote future adherence to the path agreed upon in the budget resolution. Therefore, the most reliable positive impact of the reform would be to increase the ownership of other key congressional committees of the budget resolution and its vision for fiscal policy. This would have the greatest impact during years in which reconciliation is used to convert the budget resolution targets into legislative actions to increase taxes and cut spending.

Other Incentives for Adoption. Absent a change in membership of the Budget Committees, are there particular sanctions or other incentives that might encourage the Congress to adopt a budget resolution?

Even with the membership change discussed above, Congress does not have incentives to pass the budget resolution—particularly one that inflicts budgetary pain in pursuit of deficit reduction—unless there are some repercussions for failing to do so. What kinds of negative sanctions might encourage adoption?

- If the failure to adopt a budget resolution much more clearly impacted the ability to pursue other legislation—especially appropriation bills—then the overall Congress is likely to pay more attention to its passage. Currently, in the House, appropriation bills can begin to move on May 15th even without a budget resolution. This "fail-safe" means that many may believe that there is no real consequence for failing to enact the resolution. Further, the Senate

tends to not enforce the point of order against consideration of appropriation bills in the absence of a budget resolution.

- In addition to, or instead of the above, new points of order, requiring supermajorities in both houses to waive, could be created against any legislation that CBO says increases spending or decreases revenues, in absence of a budget resolution.

- Even more substantial incentives might be created if automatic tax increases or spending cuts were triggered by the failure to enact a budget resolution prior to some specific date, or prior to the beginning of a particular fiscal year. If failure to adopt a budget resolution triggers an alternative that is sufficiently abhorrent to Congress (on both sides of the aisle) it will create an incentive to reach agreement.

These are only three possible suggestions. They are by no means an exhaustive list. The important point is that, unless there is some consequence for failing to enact a budget resolution, and it affects something that a broader cross-section of the Congress actually cares about, it is unlikely that the Congress has the incentives to improve its recent, rather dismal budget resolution record.

Conclusion

Historically, the budget resolution has only been relevant when there was a broad commitment toward some particular budget policy. That budget vision might come from the president, as it has periodically. In addition to (and perhaps even instead of) the president taking the lead, leadership may come from within Congress. Making the budget resolution into a joint resolution seems like unilateral Congressional disarmament. It seems more fruitful to attempt to determine what institutional factors or other incentives could promote more effective functioning of the concurrent resolution process that already exists. There are no procedural hurdles that prevent the Congress from acting today. If the Congress believes some change needs to be made, it might be more fruitful to think through the incentives and sanctions that might be used to encourage the current process to work more as intended, rather than shifting more power to the President.

Chairman CONRAD. Thank you.

Dr. Posner is next. Dr. Posner is director of the Centers on the Public Service at George Mason University's Department of Public and International Affairs. Thank you so much for being here, and give your testimony and then we will open it to questions.

STATEMENT OF PAUL L. POSNER, PH.D., DIRECTOR, CENTERS ON THE PUBLIC SERVICE, DEPARTMENT OF PUBLIC AND INTERNATIONAL AFFAIRS, GEORGE MASON UNIVERSITY

Dr. POSNER. Thank you, Mr. Chairman, Mr. Sessions, and other members of the Committee here.

I am drawing on my 14 years leading GAO's work on the Federal budget, which dealt with a lot of these issues, monitoring the Budget Act and other issues for this Committee and others, as well as a survivor of the New York City budget crisis, serving in the Budget Office in the mid 1970s there, which still burns lessons that you have learned in your mind forevermore, I think, about how to deal with fiscal stress.

I was asked to kind of comment on the implications of the congressional budget process for timeliness and lateness in funding. There is no question, as Phil said, that there have been significant delays most recently in the adoption of budget resolutions or failure to adopt budget resolutions. There is also a kind of persistent late appropriations and continuing resolutions which have hamstrung Government effectiveness. GAO did a report several years ago which kind of documented this, looking at the agencies and looking at the impact that continuing resolutions have and that funding uncertainties have on agency effectiveness and efficiency. And they found some things here: the average length of the CR in the past several years is 3 months; that the CRs cause massive delays in contracts and grants; significant rework and administrative costs; postponement of hiring and other needed work to repair and rehabilitate facilities, raising eventual costs in the future. And there is no question that the congressional budget process in general, not just the Budget Act but the appropriations and the like, have caused significant inefficiencies in Government operations. So this is an important issue that we need to deal with, if for that only, as well as more broadly addressing our budget challenges.

I think the question is: Can process reforms deal with this? And I am a political scientist, and I study kind of the history of politics and policy in the country and in the Congress, and I would note that, you know, I think the thing that is driving a lot of these problems is beyond a process fix. A lot of these problems are really driven by a more polarized and contentious political process. I do not need to tell you that we have had a massive realignment of the parties, that the middle is less represented than other sectors of the electorate. We have 24/7 media coverage. We have constant vigilance by interest groups.

It is difficult to make budget choices in a fish bowl. It is much more difficult to make the kind of budget choices we face today in a fish bowl, particularly as budget positions by members are increasingly monitored minute by minute by outside groups.

It is also difficult to budget for less. We have seen States that ordinarily put budgets in on time come late periodically in the past several years as they wrestle with hard choices and the like.

So there is no question that, you know, we need to do something here. In the old days before all of the budget process occurred and when our politics was more centrist and more consensual, why we did it informally through the appropriations process, broad agreement on priorities and the need to kind of keep the lid on the Treasury. These days we do not have that informal agreement, so we need rules to kind of fortify ourselves. But at the same time, rules are more difficult because of this more contentious kind of process.

Process cannot repeal politics. Gramm-Rudman taught that. We need to be careful about what we expect process to do. It cannot substitute for political will. It can back and reinforce political will, but we should not ask heroic things from process. Washington's landscape is littered with disillusioned reforms that have fizzled out, much to the chagrin of people who were very enthusiastic.

Now, when I look at the process reforms that might bear on late funding and delays, you know, the first is some kind of way to incent Congress to act on budget resolutions in a more timely way.

I think this problem of the failure to act is partly a symptom of our politics. It is, frankly, partly a symbol of the fact that the budgeting is partly an exercise of the whole and the parts. You know, we as Americans have one set of beliefs about the whole. We want to cut deficits. We have a totally different set of beliefs about the parts. Do not cut my program and do not raise taxes. I think that same kind of duality and ambivalence is present in the Congress, too.

The question is, I think what has happened in the budget resolution is we have kind of a misalignment between the whole and the parts. In recent years the Budget Committee and Congress has adopted spending ceilings, for example, that are symbolically appealing but unrealistic and difficult, if not impossible, to be digested by appropriators and other committees. And I think it is the fact that this Committee has not aligned itself with other committees, has not worked in that kind of collaboration, that has made budget resolutions more difficult to swallow and more difficult to get out in the first place. So I think part of the problem rests possibly with, you know, the kind of targets that we set. Now, that partly has been taken care of by the Budget Control Act over the next 10 years.

I think a higher point of order on appropriations bills, a 60-vote point of order, could possibly help. I do not think it is going to prevent polarization, which I think is the part that drags this whole process down. But it could possibly at the margin make some difference.

But I think the bottom line is I think most members feel they can get by without a budget resolution. They cannot get by without appropriations. That is the driver of behavior. So I am not sure even a 60-vote point of order is necessarily going to reverse that logic and those constraints.

The second issue I want to talk about is joint budget resolutions. Again, that has often been offered as a way to cut through this,

streamline the budget process, expedite action, and prevent gridlock. I will not say anything more about it. I think we know what that is. I think the joint budget resolution is a high-reward but high-risk proposition. When the President wants to get together, even if he is of the other party, like we had in the Andrews Air Force Base Summit in 1990, why, it can really cut through a lot of stuff and bring parties together more expeditiously. It can certainly make whatever agreements are put down in a resolution, give it the force of law. It can force other Committees to come to the table. It can bring not peace and light but real effective agreement to this process, and that is certainly something you do not want to give up. It is worth striving for.

But as has been said before, it really does not eliminate conflict. It moves it around. It takes the gridlock of the fall and moves it to the spring. And I fear that it makes the President—invites the President into a congressional process and enables him, if he wants to undermine the congressional policies, enables him to completely hamstring Congress' ability to even enact appropriations in the first place.

So I am fearful that that obviously shifts the balance of power and may prevent Congress from getting its work done as well.

I like the idea of a backup concurrent resolution triggered by something that would make sense.

I think we have to remember one thing about the Congressional Budget Act. The Congressional Budget Act was not a deficit reduction act. It was a rebalancing of power act. It was in response to the impoundment of funds by President Nixon, "the imperial Presidency," as it was called then. This was Congress' effort to reclaim power and reclaim the high position in the appropriation and budgeting of the Nation's resources. And that is something we should not tamper with lightly, obviously.

I want to make one more point. I think we are in a kind of almost inflection point in budgeting. We are facing not only the deficits of $1.2 trillion today, but unlike most recessions, even when we eventually pull out of this one, we are not going to see the light at the end of the tunnel. We are going to see the tsunami of the demographics and health care cost crisis facing us square in the face. We are looking at deficits that GAO, OMB, and CBO all project to be in the range of 20 percent of GDP if we do not do anything.

I think what we have learned from, you know, my experience in New York, New York City and other Nations that we have studies is that to deal with these kinds of policy deficits and deep divisions requires a more centralized budget process. I am not sure whether this one is up to the task, and I think we need to really think through, clearly we are going to be facing some of the most difficult choices. Many, many different third rails, not just Social Security, are going to pass through this Committee. And I think the question is: Can we rethink the budget process so that it is up to the task of dealing with these really hard choices?

One of the things that I talk about in the testimony is the idea that not only the budget process—we want the budget process to solve the broad fiscal problems, but we want it to set priorities for the Nation. I think right now those priorities are not set anywhere.

We have kind of diverging forums to consider tax expenditures and spending and other programs in highly fragmented ways, which is why GAO reported the tremendous fragmentation in Government. We have 82 teacher training programs, we have 17 food safety programs, and this is partly because of the fragmented structure here.

Worse, I think we have inconsistent policies. We try to bail people out and help prevent the damage from floods. On the other hand, we incent people to locate on the ocean with flood insurance. We do not look at the conflicts within our own policies. And I think what we need as a budget process—I think that is part of the budget process, to kind of bring together the committees and the leaders in this Congress to rationalize policy and do what I call "portfolio review," looking at the performance of what we are getting, the relative performance of the different programs all trying to achieve the same thing. I call it a "performance resolution." Whatever it is, I think we need to really think about performance as we think about reviewing these claims.

I think the Budget Committee is uniquely positioned of any committee in this Congress to do this job. You already look at budget functions. They are kind of a natural way to express the missions of the nation. Subfunctions may be even better. Something needs to be done, I think, to bring this body together around these urgent problems.

Thank you.

[The prepared statement of Dr. Posner follows:]

Statement of Paul L. Posner
Centers on the Public Service
George Mason University

Before the

Senate Committee on the Budget

October 12, 2011

Strengthening the Congressional Budget Process: The Role of Process Reforms

Paul L. Posner
George Mason University

Thank you Chairman Conrad and Ranking Member Sessions and other members of the Committee. I appreciate the opportunity to testify on ways to improve the timeliness of the congressional budget process. In particular, I have been asked to comment on a provision of new proposed legislation strengthening the incentives for Congress to adopt a budget resolution before appropriations bills. I have also been asked to comment on the potential efficacy of a joint budget resolution in streamlining the budget process.

There is no question that Congress can improve the efficiency of its budget decision-making. Trends toward greater uncertainty and delays in funding have effects not only on public confidence in the Congress but also on program delivery and costs. The real question is whether budget process reforms can solve these problems and at what cost to other values and priorities we care about. Real reforms can be made by strengthening the role of this committee and promoting greater coordination and integration across the committees with roles to play in resource allocation. Such reforms are especially critical as the nation enters what is likely to be a prolonged period of fiscal austerity. However, these reforms would affect the political standing of competing interests and actors in ways that could very well change the character of the Congress.

The problem of untimely congressional policy actions

The congressional budget process envisions at two-step process in congressional budgeting. The first is the annual adoption of a budget resolution establishing aggregate levels of revenues, spending, the debt limit and surplus and deficits. In addition, the resolution includes allocations of spending across budget functions and to committees through Section 302(a) ceilings. Appropriators subsequently make their own allocations to their subcommittees under Section 302(b). Points of order could be raised against appropriations bills that either breached these ceilings or were moved in the absence of a budget resolution.

Absent a budget resolution, appropriations can proceed by relying on the levels from the prior year's budget resolution. However, since these targets typically become outdated, both chambers have adopted deeming resolutions to provide the basis for appropriations to go forward. Moreover, in certain years, the Senate considered appropriations bills using the Senate passed budget resolution without moving a formal deeming resolution.[1]

In recent years, significant delays have occurred in recent years in both the adoption of budget resolutions and appropriations bills. For 31 of 36 years between FY 1976 and

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[1] Megan Suzanne Lynch, *The Deeming Resolution: A Budget Enforcement Tool* (CRS: June 9, 2011)

2011, the House and Senate adopted at least one budget resolution. Agreement was reached in April through early June which allowed regular appropriations bills to be brought to floor of each chamber. However in recent years, Congress has failed to adopt a budget resolution five times - FY 1999, 2003, 2005, 2007, and 2011.

Late appropriations, or no regular appropriations, have become an increasingly regular occurrence, even in years when budget resolutions were passed. Beginning in the early 1970s, conflicts between the President and Congress over major budget priorities, triggered in part by rapidly increasing deficits, greatly increased the difficulty of reaching final agreements on regular appropriations acts, even after the start of the fiscal year was shifted from July 1 to October 1. The last year when all 13 appropriations bills were passed individually before October 1 was 1997. Since then, omnibus bills have provided appropriations for many years, but continuing resolutions have also filled the void when political conflict prevented timely congressional appropriations. [2]

In their analysis, GAO found that the duration of individual CRs enacted from 1999 to 2009 ranged from 1 to 157 days and the number of CRs enacted in each year ranged from 2 to 21. The average length of the CR period was about 3 months.[3]

Most continuing resolutions provided funding for agencies at conservative levels, often referencing levels from last year's appropriation or the lowest of pending appropriations bills. While lower spending may be welcomed by many, the GAO report found significant problems stemming from uncertainty about funding for federal agencies and program managers. The consequences included:

--Delays in contracts and grants as agencies postpone commitments until full appropriations for the year become clearer. As a result, the time available to process these commitments becomes compressed near the end of the fiscal year.

--Postponement of needed work which increases eventual costs. For instance, the Veterans medical centers postponed contracts for repairs to facilities, a delay which was expected to increase costs.

--Hoarding and delays in allocating resources for such items as travel, training and other federal costs, as agencies await full appropriations before making full year commitments

--Delays in hiring new staff, at a time when federal agencies are in need of replenishment of an aging workforce.

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[2] Sandy Streter, *The Congressional Appropriations Process: An introduction* (CRS: Decenber 2, 2010)

[3] U.S. Government Accountability Office, *Continuing Resolutions: Uncertainty Limited Management Options and Increased Workload in Selected Agencies* (GAO-09-879, September, 2009)

--Agency absorption of pay increases and benefit increases under longer term CR's, even though appropriations is often pegged to last year's levels.

--Higher administrative costs from repetitive issuance of contracts and grants to fit the shorter term funding authority available under CR's.

The Role of Budget Process Reforms

The problems I have just discussed reflect a fundamental erosion of comity and agreement within the Congress on basic fiscal policy goals and direction. Budgeting has become increasingly contentious and more challenging as a result, with wide ranging consequences – including delays.

The past 40 years has witnessed the collapse of the middle ground in national policy institutions, as the parties realigned regionally and became more polarized, with Members playing more to the activists of newly reinvigorated parties

The tradeoffs and hard choices that budgeting requires are far more difficult to achieve under this new political system. The virtual fish bowl of media and interest group coverage makes forming coalitions and winning necessary concessions far more difficult and even politically hazardous for Members of Congress and Presidents alike. The disappearing middle in Washington removed the ballast that is often so essential to bring about fiscal order from the political cacophony.

Budgeting, at one time the quiet province of incremental decision-making by Members from safe seats, has been transformed into a series of litmus tests on the fealty of Members of Congress to key constituencies and ideologies. Under such a political system, agreement is harder to come by – and delays are far more likely.

This is not the only factor inhibiting timely agreement on budget resolutions. The budget choices facing policymakers have become far more difficult. Facing record peacetime deficits, policymakers must craft a budget resolution that puts the nation on a more sustainable fiscal course, and this involves considering painful cuts on the spending side as well as tax increases. States which have historically had good records of meeting appropriations deadlines have recently experienced notorious delays extending several months in states like California and Minnesota, owing to the difficult choices they faced in erasing deep deficits.

Does this mean that we should give up and cancel this hearing? Of course not. Budget process reforms can make a difference under this more contentious system, but we should be warned against assigning heroic expectations to such reforms. After all, the federal landscape is littered with budget process reforms that, however well intentioned, make little or no difference to the real world of Congressional budgeting.

So, under what circumstances can budget rules changes make a difference? We have learned that the process rules that work best are those that reinforce political agreements that have been struck between the parties. Gramm Rudman taught us the folly of expecting budget process reforms to prompt leaders to make painful cuts before they are ready to embrace them. The Budget Enforcement Act of 1990 budget controls worked better because they enforced an agreement that had been made at the Andrew Air Force budget summit between party leaders on budget totals and deficit reduction.

Budget process reforms can play a useful role in protecting leaders from blame for making difficult choices. By tying the hands of decision makers, budget rules can provide politically compelling ways to fend off political pressures from the load voices of contending groups in our system.

Moreover, there are times when processes such as points of order can help elevate the relative standing of fiscal sacrifice in comparison to other competing goals. Like most Americans, political leaders are ambivalent about budget choices – we want lower deficits in general but shrink from spending cuts or tax increases required to accomplish these broader fiscal goals. A point of order against breaching budget targets or ceilings, for instance, can help frame the political debate by reinforcing the salience of fiscal goals over other competing values and priorities.

No Budget, No Appropriations Rule

The proposed new rule attempts to reinforce the urgency of passing budget resolution by creating a higher bar against the consideration of appropriations bills in the absence of a budget resolution. While the current process provides for a point of order against this, it can be waived with a simple majority. The new provision would require 60 votes.

I think that the goal of this proposal is laudable. Consistent with the Congressional Budget Act itself, it would reinforce the principal that individual legislation should pass only after Congress provides an overarching fiscal plan and set of goals for spending and revenues.

The question is whether the stronger point of order would succeed in promoting agreement on budget resolutions. By making it more difficult to move appropriations bills, the theory is that this might create broader incentives to pass the budget resolution on time.

However, as discussed above, such a point of order may not be sufficient to overcome the deeply ingrained partisan divisions blocking agreement on high level fiscal policy these days. If the necessary 60 votes cannot be attained for proceeding, the question is what other effects this point of order may have. While Congress

could respond by passing budget resolutions, it might instead have the effect of hamstringing the passage of regular appropriations bills, leading to even greater reliance on continuing resolutions. A key question that needs clarification in this regard is whether continuing resolutions may also be blocked by this point of order. If so, then the new hurdle might precipitate an appropriations stand off, escalating the threat of a government shut down.

I doubt that such an apocalyptic outcome would actually occur. Often, the most profound effects of points of order are the informal leverage they give to some interests over others. The threat of holding up appropriations may in fact give leverage to those on the budget committee seeking greater leverage over the content of the resolution itself as well as the subsequent appropriations bills.

One potential outcome is that there may be a price for gaining the necessary 60 votes necessary to proceed on appropriations. This price could include higher spending in the budget resolution itself. Another potential outcome of increasing the stakes associated with passing a budget resolution is the passage of a resolution that fails to set decisive and challenging targets for discretionary spendi.ng. The point is that the future consequences of such a change may be wide ranging and difficult to predict.

The foregoing illustrates that the challenge of contemporary congressional budgeting involves balancing the whole against the parts of the budget. If the individual committees can move bills in the absence of agreement on the whole budget, then the fiscal position of the nation may very well be undermined.

However, this balancing act also be jeopardized when the whole – the budget resolution – is enacted at levels that are not sustainable by the parts – the committees.

Members of Congress and staff have pointed to budget resolutions in recent years whose discretionary totals have become primarily symbolic – enacted by members anxious to appear to be politically correct on overall fiscal policy, yet mandating a level of cuts to programs in subsequent appropriations that are simply not politically supportable. In these cases, the budget resolution may pass – but it loses its relevance and credibility as a guidance framework for subsequent decisions. As we learned in the surplus years, such budget ceilings will assuredly be undermined in the appropriations process if they are out line with prevailing political consensus. As Rudy Penner has observed, budget constraints and rules can only nudge Congress toward rationality; they cannot bludgeon Congress into it.[4]

In considering the proposed point of order, it is important to ensure that the appropriations committees are guided by fiscal policy. But in doing so, it is also

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[4] Rudy Penner, *Repairing the Congressional Budget Process* (Washington: Urban Institute, 2002)

important that the budget committees promulgate fiscal policy guidelines that are politically sustainable, lest they ultimately lose their legitimacy and leverage.

Joint Budget Resolution

Over the years, some have proposed a joint budget resolution as a way to cut through the gridlock between Congress and the President. The idea is that by involving the President up front in negotiating and approving a budget resolution, the subsequent budget process within Congress would be carried out more expeditiously. Budget resolutions and appropriations bills in compliance with the overarching targets would have a greater chance of gaining support on time, limiting the chronic uncertainty that has plagued federal budgeting in recent years.

In effect, the joint budget resolution would become a statute. The discretionary appropriations ceilings would become legally enforceable caps. Reconciliation could be mandated on the committees as part of this process. In fact, some envision that reconciliation actions could be included in this resolution, thereby skipping the engagement of committees in the process.

The prospect of a joint budget resolution is alluring indeed. If Congress and President can act together, our government would gain newfound clarity and capacity to resolve knotty fiscal challenges. Because it has statutory status, a joint budget resolution would have greater potential impact on other committees in the Congress, as well as the President himself.

As noted above, concurrent budget resolutions have all too often lately become symbolic expressions of fiscal policy, detached from the committees that must accept and implement this broad guidance in subsequent appropriations and authorization decisions. On the other hand, a joint resolution would have the standing to reunite the whole and the parts of congressional budgeting. Committees would have greater potential incentives to pay attention to the consequences of a measure that will have the full effect of a statute than they might to a congressional resolution.

Having said this, I am not optimistic that such a high-minded process would be workable in our system. It is ideal for a Parliamentary system. In fact, it resembles a system that is used in the Netherlands, where the coalition of parties that comes to power has a four-year agreement including the adoption of overarching fiscal policy goals. In our system of separation of powers and divided party control of government, the prospects for a front loaded agreement between Congress and the President are often dim.

The model for this process was the Andrews Air Force Summit that gave rise to the five-year budget agreement of 1990, along with the Budget Enforcement Act. Indeed, this proved to establish a multi year framework that was sustainable thanks

to the commitment of both the President and Congress of different parties to the fiscal goals underlying the agreement.

However, large agreements such as Andrews Air Force summits happen perhaps only once a generation. Indeed, several short years later, we returned to an era of highly partisan budgeting, featuring strongly partisan divides on budget resolutions and a government shutdown when the parties failed to agree on appropriations.

Far from streamlining and resolving budgetary conflicts earlier, it is likely that deep-seated divisions over fiscal policy would be moved around from the back end to the front end of the process. Gridlock at the front end would prevent Congress from going forward with appropriations as well as other mandatory and revenue actions it could take on its own under the concurrent resolution system.

This points to another concern I have with the joint resolution process. It deprives Congress of its own unique policymaking capacity to budget by inviting the President in at the front end. While many argue that this is a risk worth taking, I remain concerned that the President could, in effect, prevent normal congressional policymaking processes from going forward by refusing to agree to a joint resolution. At the very least, he would gain new leverage over congressional decisions, a prospect that would alter the balance of power in our system.

One constructive modification would retain the concurrent congressional budget resolution as a fall back. The Comprehensive Budget Process Reform Act of 1999, co-authored by Congressmen Nussell and Cardin, provided such a fall back procedure if the two branches failed to agree.[5] This is certainly helpful, but the decision about whether and when to abandon the joint resolution process would be necessarily political, with potential to delay and derail the budgetary timetable.

Concluding observations

This Committee faces a series of important choices as it wrestles with the budget and the economy of today and the future. We now stand on the precipice of truly daunting fiscal challenges, both in the near and longer term. Fiscal retrenchment entails truly difficult choices both for the Congress and painful outcomes for the publics that you serve.

We have learned from other nations, and from our own states and cities, that hard fiscal times often inspire a more centralized budgetary decision making process. Such a process needs to be empowered to make tradeoffs across the entire budget, and have the leverage and credibility to force the many claimants to play by new rules. Indeed, the new Joint Select Committee on Deficit Reduction shows that even the decentralized Congress has seen fit to create a new centralized institution to muster consensus necessary to meet new deficit reduction targets.

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[5] H. Rept. No. 198 (Part 2), 106th Cong., 1st Sess. 3 (1999).

I fear that the current budget process needs help in dealing with this challenging task. The budget resolution has become more symbolic than real – a way of expressing the views of a party or faction, of demonstrating a position, rather than a realistic set of constraints. In fact, this symbolic role has resulted in targets that are not enforceable, leading to supplementals, continuing resolutions and other devices to reconcile symbolic deficit reduction with other priorities members have. I fear that the committee does not have the standing or leverage with other committees to force the kinds of hard choices necessary in the future.

The process also does not serve as a vehicle to drive a more comprehensive review of priorities across federal programs and funding tools. Ideally, achieving our macro fiscal goals should be driven by a process which encourages policymakers in Congress and the Executive to focus on weak claims, not weak claimants as one former budget director stated.

As we think about the priorities of government, it has become more apparent that the important goals and objectives of policy cut across the narrow confines of budget accounts, bureaus, and congressional committees. For instance, nearly one half of the budget authority for homeland security is provided by numerous agencies outside the Department of Homeland Security. Indeed, most of the major missions of government transcend the boundaries of the federal government itself, requiring partnerships with state and local governments, nonprofit organizations and private for profit firms. GAO's work points to systemic fragmentation and overlap across government agencies and programs serving common objectives.

We know that we will have to make hard choices involving spending and revenues in the relatively near future to confront these fiscal challenges. A performance assessment process may help lay the groundwork for making choices that not only resolve underlying fiscal deficits but also promote improved performance by reexamining existing program commitments. Ideally, such a process would consider the entire portfolio of federal programs and activities addressing similar goals and outcomes, including mandatory and discretionary spending as well as tax expenditures.

There are profound institutional barriers to making tradeoffs between spending programs across different agencies and committees. While the declining share of budgets devoted to discretionary spending are reviewed each year, periodic reviews of mandatory and tax expenditure programs are generally not encouraged. Tradeoffs between spending programs and tax expenditures are strongly discouraged, even though both tax credit and spending programs both address

common purposes such as financing higher education, child care, job training, low income housing and research and development.[6]

The budget committees were established precisely to lead and coordinate crosscutting assessments of budgetary choices. The Budget Committee not only has a government-wide perspective, but also uses budget functions as building blocks for the budget resolution. Functions and subfunctions serve as proxies for broad missions or goals that can be the foundation for systematic performance assessments of the myriad of programs and tools addressing each mission. Moreover, the annual budget focus gives these Committees a routine responsibility that can be coupled to the performance assessment process.

My hope is that the Congress would adopt a systematic performance based review process linked to the budget process. The Budget Committees could be the vehicle to accomplish this by reporting out a "congressional performance resolution" as part of the budget resolution. Such a resolution could be the vehicle to engage the full Congress in debate over those areas most ripe for review and assessment each year

I recognize that this is a heavy lift for this, or any committee of the Congress. To make it work, the budget committees would have to become leadership committees, with membership from the leaders of the other major committees of the Congress. This was in fact a recommendation of the Peterson-Pew Commission on Budget Reform, a group that I served with as a consultant.[7] The hope is that, as Phil Joyce has written, such a "supercommittee" would increase the ownership of the other committees in budget targets and restraints that they help set. [8]

That concludes my statement. I would be happy to answer any questions the Committee may have.

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[6] U.S. Government Accountability Office, *Government Performance and Accountability: Tax Expenditures Represent a Substantial Federal Commitment and Need to Be Reexamined*, GAO-05-690, 2005.

[7] Peterson-Pew Commission on Budget Reform, *Getting Back to Black*, November, 2010.

[8] Phil Joyce, *Strengthening the Budget Committees: Institutional reforms to promote fiscally responsible budgeting in Congress*, (Washington: Pew, January, 2011)

Chairman CONRAD. Thank you. I thank all the witnesses.

Let me ask you a series of questions, and I would ask you, because of the limits of time here, if you would try to keep your answers as short as you can because I have a series of things I would like to get to.

First of all, the question of a joint resolution, and I would like your direct recommendation. Do you believe this should be a document that the President ultimately has to sign? Or should we keep with the current practice that it is a congressional document? Dr. Fisher?

Dr. FISHER. Yes, I think the risks of a joint budget resolution are too great. I think you would lose your independence. I am very much on separation of powers and checks and balances and representative Government.

I think we have seen particularly since World War II a huge increase in Presidential power. There are many reasons for that. And with that increase in power in the Presidency to me have come colossal mistakes by not just executive overreaching but incompetence. So I do not want to see Congress weakened in any way.

Chairman CONRAD. The Presidents, by the way, would like to meet with you right after the hearing. [Laughter.]

Dr. FISHER. I know. I have got a dinner engagement at the White House.

Chairman CONRAD. Okay.

Dr. FISHER. I think it is very odd, the attitude. People are very realistic about Congress, generally critical. I think maybe we idealize the Supreme Court too much. But we vastly idealize the Presidency. The President is someone with the national interest in mind, surrounded by very competent advisers. You know, just a complete separation between the President as it is and the way the President—if the President is this strong, he should be sending up a responsible budget. No one holds the President accountable.

Chairman CONRAD. Dr. Joyce.

Dr. JOYCE. I do not think you should change the budget process to make it a joint resolution, and I think, as I suggested in my testimony, that it would only help at the margin during those cases when the Congress and the President already are inclined to agree, and it would make things worse in cases where they are not inclined to agree.

Chairman CONRAD. Dr. Posner.

Dr. POSNER. I agree with Phil and Lou on that, absolutely.

Chairman CONRAD. Okay. Let me go to the second question just quickly. The second part of this hearing is a question of how do we provide incentives for Congress to actually take up a budget resolution? One of the ideas I mentioned in my opening was strengthening the right of Senators to proceed to and debate a budget resolution if the Budget Committee or the Senate fails to act. What is your reaction to trying to strengthen the right of a Senator to proceed—the right of Senators to proceed to a budget if the Budget Committee fails to act? Dr. Fisher.

Dr. FISHER. I think you have to protect your—as Ron said, the key parts, appropriation bills and other things that have to go on. And if the budget resolution is not ready, I think the other parts of Congress have to proceed.

Chairman CONRAD. Okay. Dr. Joyce.

Dr. JOYCE. I think anything that you can do to create incentives to have a budget resolution adopted is worth doing. And I think that it would put pressure on the Budget Committees. If the Budget Committees did not feel like they had complete control of whether there is a budget resolution or not, but thought that other Senators might actually in a sense take over their role, that to me would create greater incentives for the Budget Committee to want to complete its work. And it strikes me, while I have not thought about it a lot, as a good idea.

Chairman CONRAD. Dr. Posner.

Dr. POSNER. I think it could have the same effect that a discharge petition has, say, in the House, where the threat of losing jurisdiction and control can really focus the mind of the committees and maybe produce more action than you otherwise would.

Chairman CONRAD. Okay. Let me go to the second major proposal, which is to create a 60-vote point of order against appropriations or perhaps revenue bills or perhaps all legislation until a budget resolution is enacted. Dr. Fisher, you have kind of already answered that. You do not particularly like that idea, I take from your previous answer.

Dr. FISHER. That is correct.

Chairman CONRAD. Dr. Joyce.

Dr. JOYCE. I am more sympathetic to the idea, and, again, I think that if we are going to say that the budget resolution is where the budget policy for the Congress is being made, then the idea that you can sort of proceed to do things that involve taxing people and spending money outside of the context of that budget resolution without making it difficult for people to do that strikes me as not a good idea. And so it is not just in the Senate where you could have a 60-vote point of order, but in the House, I believe it is true that if a budget resolution has not been adopted by May 15th, then appropriations bills can be considered in the House. So I would think you would want to look at both of those things. You know, you are thinking about the Senate, quite reasonably. But I think there is also a House part of this.

Chairman CONRAD. Component, yes.

Dr. Posner.

Dr. POSNER. I think that in principle, you know, the whole point of the Budget Act is to set the plan in motion first and then have the individual actions follow. And the extent to which there is leakage is a problem.

I think there are some real implementation questions. For example, would that 60-vote point of order hold against a CR as opposed to just appropriations? And if it does, then you really escalate the potential for a possible shutdown. Do you, in fact, through the back door in effect create a 60-vote requirement for appropriations bills through this process by enabling members to hold up an appropriation absent the 60 votes?

I think the other question is sometimes these points of order are effective in achieving their goals, and sometimes they just raise the price of an agreement. You know, given the necessity of passing appropriations, whether the need to gain the support of those other

votes, whether that would increase spending, kind of counterintuitively, or other actions remains to be seen.

But I think in principle it is a good idea to have some kind of sanction of shame or other kinds if things do not work, but, on the other hand, there are some unintended consequences we have to pay attention to.

Chairman CONRAD. You know, the thing I have been struggling with is I have been on this Committee 25 years; I have been Chairman, I have been Ranking Member. You know, the hard reality is if you are in leadership, it is not all that attractive to take up a budget resolution and go through vote-a-rama. I would just tell you, our colleagues do not look forward to the prospect of going through vote-a-rama. It has become an object of derision. That is the fact of the matter.

And, you know, you have got other committee chairmen who have never particularly liked the existence of the Budget Committee. Let us also be frank about that. I mean, if you are an appropriator, the Budget Committee is not a real attractive inconvenience. And if you are the Finance Committee, you know, same thing. You are not very eager to have the Budget Committee telling you what your limits are. And I will tell you, they all can go to leadership.

So I am convinced, unless we provide some additional incentive or disincentive around a budget resolution—I mean, we can see what is happening. You go back to 2000. Only one time have we done a budget in an election year. I was Chairman of the Committee then. I remember how hard it was. And the way I persuaded the leadership to do it——

Senator SESSIONS. Presidential election year?

Chairman CONRAD. In a Presidential election year. The way I persuaded them to do it was to tell them if we do not, any member can go to the floor with a budget resolution. That was the thing that convinced them to go ahead. So that is the thing that I think we should seriously think about strengthening.

With that, I have exceeded my time. Senator Sessions.

Senator SESSIONS. Well, thank you. To me the budget power is only one, really, which is it sets how much money we can spend. That is the fundamental power that we have, and we have arranged it so that it can be passed with a simple majority, not a super majority, and created some power to make sure that it could be carried out once adopted. That is a good thing.

I have heard it argued that when the appropriators did not have a budget to try to get around, they were more anxious themselves to contain their own spending. You know, we have heard that argument before, and there may be something to it.

With regard to the leadership, I would go a little bit deeper into what I think the concern is. If we had unleased a national discussion, a lot of votes and a lot of amendments and a lot of discussion on the financial future of America all year, leaders on both sides would have somewhat lost control. The process would have been more between the Senators and the American people and who is winning the battle for the hearts and minds of the American people. But when you take it off the center stage, then the leaders

have more control of it. I love them all, but that is, I think, a thing that was in their mind.

I do not think it is so much that you go through the vote-a-rama, although that is an irritant and votes can be tough for your members and leaders want to keep their members from casting tough votes. We understand that. But I really think it is a deeper deal. Democrats interpreted their huge victories when Republicans went from 55 Senators to 40 in two cycles as an affirmation of their vision of Government. The last election, Republicans interpreted their shellacking, big victory as an affirmation of their form of Government. So we have got two groups of people with some different views about what we ought to do in America about spending, taxes, and the size of Government. We just do.

And so I guess it has sort of fallen on us that we have not been able—that debate has kind of hit us here, and I am not sure where we will go from it. These odd CRs and debt ceiling agreements and all represent congressional effort to do something, and not all bad. We are not spending more now. We are spending a little less, at least over the next decade. And so it is not as if we are totally rejecting the American people's views that we need to get our house in order, in my view.

We talked about the point of order there. Dr. Posner, one thing that I have thought was fundamental to our biennial budget colleagues is biennial appropriations. And one thing a member of the Appropriations Committee told me several years ago when I was promoting this, "Well, that is great. I am for biennial budgeting, but I am not for biennial appropriations." Well, I thought biennial appropriations is exactly what we need. Just imagine the immensity of the Defense Department and how much confidence they would have if they had a 2-year plan that was pretty firmly done.

But you had some doubts about that. Would you express those to us?

Dr. POSNER. Well, I think you can distinguish between biennial budgeting and biennial appropriations. I think it is conceivable that you could have a biennial budget resolution, particularly in years when there is no reason to change the overall top-level fiscal policy, and still have annual appropriations.

I think that the question about biennial budgeting, you know, is one I know that you focused on last week, and it is perennially a focus here. I guess I think that certainly some of the States have it, mostly the smaller States. I think the purported advantages of biennial budgeting are dependent on having a clean 2-year cycle. If you have to revisit your budget every year, then you are just creating the same amount of work that you did before.

I also kind of think that, you know, while it certainly could lead to more oversight—and we have seen some State legislatures, Arizona in recent years, that have actually done that, Texas to some extent. I think the real oversight that takes place—and I have got an old-fashioned view about this—takes place in the Appropriations Committee when you actually appropriate money. That is where the incentive is to really monitor and oversee and control what the agencies are doing when you are getting their budget. It is a telephone book, as you know, that is replete with detailed information on workload and location and regional performance and

this and that. That is when you really have the members' attention. And I worry for the quality of oversight, I worry for congressional control, not having that being done every year, frankly.

So I think that there could be a case to be made for biennial budget resolutions, but I do not think the case is as strong for biennial appropriations, and I certainly think in a Government as complex as ours, which is so sensitive to the economy—we are not as insulated from the economy as some State governments are—I think we will be constantly changing it anyway. So I do not think we are going to get the advantages that we would otherwise.

Senator SESSIONS. Well, Dr. Joyce, I will let you comment on that. Of course, the theory is that we would do more oversight in the off years, and certainly the Budget Committee could. But Dr. Posner raises a good thought. What are your comments? My time is running down.

Dr. POSNER. Well, just real quickly, I think I agree completely that—I find myself in the position of agreeing with all of the good things that biennial budgeting is supposed to bring, but being very skeptical that they will happen. And I think the two things that biennial budgeting is supposed to bring is less time on budgeting and more time for oversight, and I think the less time on budgeting part really is tied up in the appropriations process. And I think particularly in the House where appropriations is an exclusive assignment, then, you know, you have to ask your the question: Are those House appropriators going to take every other year off from budgeting? And I think they are probably not.

On oversight, I think that the reasons that more detailed oversight, the kind of performance-based oversight that people are looking for is not done does not have to do with time as much as it has to do with there is not incentive to do that kind of oversight. That is hard work, looking into programs from the ground up. And I think the reason it is not done is because Members of Congress do not sort of see the payoff from doing it.

Senator SESSIONS. Dr. Fisher, do you want to comment? My time is up. Go ahead.

Dr. FISHER. A quick comment on 2-year appropriations. Agencies now have a hard time estimating 1 year out for the next year, and they have to do some padding. So I think the agencies would do a lot of padding for 2 years, and then Congress would have a tough choice. One is to be very conservative on your funding for 2 years, in which case you would have to do supplementals the next year—that would be a headache—or to give too much, which is wasteful. I am sure you would have to give agencies much more discretion on transferring funds from one account to another or reprogramming within an account.

So I think the difficulty of estimating, particularly at the national level, makes 2-year budgeting not practical.

Senator SESSIONS. Two-year budgeting and appropriations?

Dr. FISHER. Pardon?

Senator SESSIONS. Both 2-year budgeting and 2-year appropriations?

Dr. FISHER. I think 2-year appropriations would not be practical. I think it would bring a lot of headaches. I certainly have reservations about biennial budgeting as well.

Chairman CONRAD. Let me just say I have been on this Committee 25 years. If there is anything that is clear, it is that we are not going to be doing budgets in Presidential or in election years. So people do not want to do a biennial budget, we would not do any budget, because that is where we would be. At some point we have got to deal with reality around here.

Senator Warner.

Senator WARNER. Thank you, Mr. Chairman. I really appreciate you and the Ranking Member holding this hearing, and I appreciate the panel's comments. You have surprised me a little bit. You raised some good questions, but I still absolutely believe the notion of biennial budgeting makes sense.

I am biased as a Governor from a State that had that process, and we had an ability on the off year to have appropriations amendments that grew and grew and grew, and it ended up being a mini process. But still there was at least a framework, and the lack of predictability and the lack of incentives we have, I actually think a 2-year budgeting process and a 2-year appropriations process, in the off year having appropriation amendments would, with appropriate guidelines, cut back on the kind of end-of-year finagling that many agencies do at this point, would not exacerbate it. But you raise some interesting points.

I was also surprised to hear—Senator Thune was out for most of this. I found when we had kind of a more private conversation, I made mention of the fact that it was not until I was on the Budget Committee as a relatively new Member of the Senate that I realized the budget that we do here was not signed by the President or did not have any kind of effect in law. And, again, the reluctance of all three of you to embrace that approach when it seems, again, that the overwhelming majority of States have that kind of gubernatorial role in the budget, I would like you to comment on that.

I was also curious to see, other than Dr. Joyce, the relative pushback on the ideas the Chairman had about incentives and/or penalties that if we did not get a budget done by a certain moment in time, these other thing would kick in—again, seeming to say that the status quo was an acceptable—or at least better than some of the other options. I do not accept that.

I would say one of the things that Dr. Posner has raised, and I believe Dr. Joyce raised as well, and I think is something that this Committee has a unique ability to do is to do this performance and metrics review. It is tough work. The Chairman, at the suggestion of Senator Whitehouse, had given me and a group an ability to dig into some of this, and passed a little piece of legislation last year, the GPRA Modernization Act, that actually required agencies for the first time ever to limit the number of their policy goals so they do not have this, you know, you have too many goals, you do not have any priorities. Actually for the first time ever, it makes requirements for agencies to not only focus on their best-performing projects but also their least-performing programs, which is a cut line that no agency would like to make, but I think is important information we ought to have. And if it is not the Budget Committee, I do not know where we are going to be able to get a look at the kind of duplication of programs that cut across appropriation lines. We all cite the same 82 teacher training programs, you know,

90-odd worker training programs, 17 food safety programs. And regardless of which side of the aisle, we know those are important functions, but there is no incentive in place right now or no place to see how do we evaluate these particularly across agency or Committee jurisdiction lines. The Budget Committee has got to be the place.

This is much too long a comment from me and not enough of a question. I guess my question will be: Any other comment on the biennial versus the current process on both budgeting and appropriations? And since so many States have had a fairly effective way to do it, the notion of not involving the President in the process, which you are uniformly against, again, I do not think there are very many States at all that I am aware of that do not have a gubernatorial involvement either at the front end or the back end of the budgeting process. And why has that worked relatively well for States and not worked so well at the national level?

Then, again, since I have talked so long and used up most of my time, any further comments on how we could incent us to get it aligned right, to spend the time on performance, to spend the time on metrics, and to spend the time on this cross-cutting analysis and getting out of silos. So I guess we will do it in line.

Dr. FISHER. I do not think the States are a good place for Congress to look for advice. You can do it, but States had biennial budgeting because they met every other year, in Congress from 1789 on, every year, every year, every year. So there are also things at the national level that just do not exist on the State level.

I do want to make—oh, yes, they have gone back and forth on this. But I want to make a point about the President getting involved in a budget resolution, a joint budget resolution. I am very concerned that it would cut down on the participation of Members of Congress. Who would negotiate the joint budget resolution? I think you would have a handful of people—and the frustration at Andrews where you have to slip notes in, can you look at this note and help me out? I mean, that is pathetic for a body like Congress. So I am afraid it would go in that direction.

Dr. JOYCE. On the States, in the first place I think that there is a lot of variation among the States. There are States that are characterized, rightly, as having very strong legislatures like the Congress is a strong legislative body. There are other States that have relatively weak legislatures. Part of that is dependent on, for example, the extent of the veto power that the Governor has, you know, whether it is a line-item veto, a reduction veto, or whatever.

But I think the other thing is that the States—and you can try to take this on, if you would like to, at the national level, but the States are not nearly as fragmented in the way they deal with the budget as the Congress is. You know, the States often will have an Appropriations Committee that deals with all spending, not have a lot of spending that is under the jurisdiction of other committees, as is true here. Or they may even have a single Budget Committee that deals with both the tax and spending side of the budget.

So at the State level, the Governor proposes the budget. The Governor may have a lot of power in terms of vetoing what comes out of the legislature. But then the question to me is: What does the legislature do in that sort of intermediate step? And can it deal

with the whole budget? That is the real function of the Budget Committee here. The reason there is a Budget Committee is because there are not any other committees in the Congress that can look at the whole budget.

Dr. POSNER. If I could just say a couple things. I think one of the reasons why biennial works in the States and not at the Federal level is we have a unique role to be the stewards of the economy, and the States do not. And that means that particularly in volatile times, but even in—you know, our fiscal responsibilities continue much more intensely and much more regularly than States may. So I think that is something we have not talked about yet, but I think that is important.

I think, generally speaking, Governors are stronger than Presidents. Legislatures in States are comparatively weaker in budgeting. For example, one of the things that makes biennial budgets work, as you say, is State agencies have the ability to adjust. Governors can impound money. The legislatures sometimes can convene interim committees to act on behalf of the whole legislature. There is a lot more flexibility that we would not do here. Our Congress is much more fulsome and proactive, and I think it makes it more difficult to see biennial budgeting working in that sense.

I think one of the main reasons why I think about biennial budget resolutions is precisely what you said, and that task force that you led I think was a great example of this: the potential of this Committee in the off year to do the kind of focused oversight of those portfolios that just is not done and is desperately needed. I think that is a role that this Committee could play, and this Committee could really do that in the biennium, in the off year. So in that sense, I think if we can kind of move in that direction, that would be a real positive advance.

Senator WARNER. Thank you, Mr. Chairman.

Chairman CONRAD. Senator Thune.

Senator THUNE. Thank you, Mr. Chairman. I thank you and the Ranking Member for holding this hearing. I think it is an important subject, and I think the special committee gives us probably the best opportunity that we have to do something in the area of budget reform that we are going to get. And that is why I think this is—we have got to seize this opportunity.

Now, I want to summarize what your arguments have been in opposition to a joint resolution that would have to be signed by the President. One is that the Executive could slow down the budget process, create unnecessary delays by, you know, being resistive to whatever Congress is trying to do there; secondly, that it would violate the checks and balances, the separation of powers, give too much power to the Executive. Is that a fair characterization of what your basic arguments are in opposition to that idea?

Dr. Joyce. I would only add one, which is that I am concerned that actually you might end up with less fiscal discipline as opposed to more, because if you involve—if you made the budget resolution a statute, then there are all kinds of things that could be changed by statute. Some of those things might be things that would offer more fiscal discipline, but it could be just as likely that the President and the Congress would agree on things that could relax fiscal discipline.

Senator THUNE. But there are limitations in the current Budget Act, which this would not change, about what can be put into the budget. Section 301 defines what would be put into a budget. So if the concern is that Congress might put more in there to load up a budget resolution or the Executive might negotiate with Congress for something along those lines, it strikes me that that would not, as the current budget statute would be applied, be permissible.

Dr. JOYCE. Well, I do not know whether that would be true or not. I mean, there are all kinds of examples of legislation, appropriations bills being one example, where all kinds of things end up in appropriations bills——

Senator THUNE. But those are appropriations bills. We are talking about a budget resolution here. The budget resolution is pretty prescriptive about what can and cannot be included in that. And this does not change the basic nature of the budget resolution. All it simply says is that at some point in the process you ought to have some buy-in from the Executive.

And I would simply say, I mean, delay the process as opposed to not doing a budget, you know, give the President more power to increase deficits, as if we do not have a $1.5 trillion deficit today. I understand all the theoretical arguments about checks and balances and about separation of powers. But we have a crisis, and that crisis is we cannot get people around here to agree on how we are going to solve the major problem facing this country, and that is the fact that we have year over year $1.3, $1.4 trillion deficits; we have a debt to GDP of 1:1; we have deficits to GDP at 10 percent. Historic levels. You would have to go back to the end of World War II to find this. And we cannot do anything about it because we are paralyzed here.

We have this goofy process that includes vote-a-rama where everybody comes in and, you know, we have these votes, we do not debate. They are mainly messaging amendments. This is a broken, dysfunctional process. And what I hear you saying is we do not like what you are proposing to do to change it, but I do not hear anybody saying here is what we have to do to fix what is a broken dysfunctional process.

Let me ask this: If you had a backup—let us say, for example, that the process failed, that the President vetoed the budget resolution. If you had a backup that would allow for a concurrent resolution or an automatic CR or something that would put some pressure on this process to get something done, wouldn't that help address the concern about us not being able to pass one? I mean, I am really struggling with the distinction here between the theoretical and the real. I mean, we are dealing with the real right now, and the real is not working. Dr. Posner.

Dr. POSNER. I would feel much better about having that backup. I think you would have to kind of have a trigger point when that backup would trigger in. I am a little concerned if you combine that with the 60-vote point of order against moving appropriations, that, you know, we would be waiting around to see if the Hail Mary works, and meanwhile the regular block-and-tackling work of Government—appropriations and other things—will get stalled in the process. And I think we have to find a way for Congress to do its work. And, yes, we want the big Andrews Air Force Base Summit.

I do not think they happen more than once in a generation. But we want to have those big-level agreements. I am totally in agreement with you. The question is: How do you do it? And how do you do it in a way that does not jeopardize other things? I think that is really the question.

I do agree that the concurrent resolution backup, if it could be done in a timely way, might help the process go forward here. But——

Senator THUNE. Well, I mean, I just look at today. We have not moved a single appropriations bill across the Senate floor. We are going to take one up this week, I hope, but we do not have one signed into law. In the last 34 years, there have been four times—four times—where we have passed the appropriations bills on time. I mean, I do not see where delaying the budget resolution by involving the Executive is going to do anything to delay a process that is already delayed.

Look at this. Last year we passed eight continuing resolutions. We did not finally get a budget until earlier this year for fiscal year 2009, which started on October 1 of last year. In 2010, we passed three CRs. In 2009, we did the omnibus in March the following year, when the fiscal year had begun the preceding year. In 2008, we did four CRs. And we end up at this back d up at the end of the day, and that is not a way to run a country.

Now, I understand democracy is imperfect, and we are never going to get it ideal around here, and it is not going to run—everything is not going to be beautiful and perfectly timed. But we have a broken, dysfunctional process, and to me, I am suggesting if—maybe this is not the way to correct it or to fix it, but it strikes me, at least, that on those occasions when we have been able to get a budget, it has often been when we have had some sort of summit where the Executive gets involved, and we sit down together and say this is what we are going to do. And at least it binds us to do something around here. Yes?

Dr. FISHER. I think all three of us agree with you, the critical state we are in, the dysfunctional budget process. My concern has been everyone keeps looking at Congress, and I think you are not going to get out of this until the United States understands that the President has an absolute duty to get it off on the right start. A lot of Presidents says, "I want a balanced budget." Well, send one up. You have got the authority to do that.

So what do we need? We need leadership from the top.

And if you get that, then your process here will work.

Senator THUNE. But the President submits a budget, and it does not matter which President it is. In the time that I have been here, the President submits the budget and Congress declares it dead on arrival. I mean, it is like that does not mean anything, we are going to write our own budget.

So you never have that buy-in. There is never that sense of ownership. And I think the American people believe, wrongly, that the President is involved.

I have talked to colleagues on this panel, and you heard Senator Warner talk, and I talked to one on our side. He said, "I never realized until I got on this Committee that the President does not sign the budget resolution." I think there is an assumption—I mean, the

President signs appropriations bills, and at the end, when we get into these big omnibuses at the end of the year, if the President wants to, he can hold the process hostage because he ultimately has the veto pen, and he can force us to come back here. I find the whole idea that involving the Executive earlier on in the process is somehow violating this notion of checks and balances and separation of powers to be completely out of touch with reality, with where we are today. And I understand when that was developed. In 1974 there were some things going on in the country where we needed that independence, and Congress was trying to assert a little bit more of its authority.

But this is a crisis, and we are paralyzed here, and I think the American people recognize that. I think it is very tough if you are an agency of Government to have any predictability when you are not going to get a budget until—you have got a CR that may be at last year's level, may be at whatever the Appropriations Committee marked, but, you know, we are going to do this until this date, and then we will try and get a budget, and then next year maybe we will get a final resolution to this. This is just—it does not work.

And so I appreciate your observations. I wish you were more supportive of what I am trying to do here. And maybe there is a better way of doing this, but I am not seeing it.

Dr. FISHER. Just one quick point. The reason budgets come up dead on arrival is because they come up irresponsibly drawn, where the President does not take any responsibility. They are unrealistic. Once Presidents did and that was the expectation, they would not be dead on arrival. You would accept the aggregates, and you would change the priorities as you like. But we have not had responsible Presidents for a long time.

Senator THUNE. Dr. Posner.

Dr. POSNER. If I could just add to that, I think you are putting a lot of your hopes with the President. I think a lot of our expectations should be to strengthen this Committee, this body. I was part of the Peterson-Pew Commission, a consultant with them, and they came out with a good Back to Black report where we said this Committee should become a leadership Committee, where the leaders of all the committees should get together and work this out. You know, whether it is every year or every other year, I think that is where a lot of the change, frankly, could be productive here.

Senator THUNE. And I do not disagree with that. We are vested with the power of the purse, and that is something, obviously, we have failed in our responsibility here, too. But all I am saying is I think there is a way that can work that is superior to what we are doing today that would get more teeth into this thing and a joint resolution.

My time has expired. Thank you, Mr. Chairman.

Chairman CONRAD. You know, I did not want to cut it off because this is a very constructive conversation, I think. And I tell you, as I say, I have been here 25 years. This just cannot keep going the way it is. This is not good. It is not good for the country. It is not good for this institution. It is not working. So the status quo, anybody who argues to me the status quo ought to be what we continue to do, I am not for it. This is not the way we should

function. And we should, I think, create a circumstance in which the incentive is so powerful for this Committee to produce a resolution and that that resolution gets to the floor, and if it does not, that an individual member can bring a resolution to the floor.

Senator Whitehouse.

Senator WHITEHOUSE. Thank you, Chairman.

Senator Thune just made two points that I want to agree with and emphasize. One is that there are huge battles going on—the Ranking Member made this point as well—huge disagreements right now, philosophical, political disagreements in Washington. The House just tried to pass a budget, voted on a budget that gets rid of Medicare in 10 years. To some of us, that just seems unimaginable, grotesque. But that is how far apart different people are.

And so when you have that, you are going to have the budget process and, frankly, in the Senate virtually everything else become a proxy war for that larger battle. We just tried to pass a bipartisan China currency bill, and we finally got to it, but we had to resort to extraordinary procedural mechanisms or at least a new procedural mechanism to avoid an unending array of completely non-germane "gotcha" amendments that had to be called up.

So, I mean, when a bipartisan bill that ends up passing—what was it—68 votes, you know, everything is a proxy war for that larger fight.

So I agree with you that that creates a problem for this budget process, but Senator Thune is also right that that does not mean that the process is not dysfunctional. The fact that perhaps now it has been overwhelmed by the ideological war in this town does not mean that it is not dysfunctional on its own. And I really think we need to fix it.

I could not agree more that vote-a-rama is a disgraceful legislative exercise, has earned the derision about it that the Chairman has referred to, and there have to be ways of, as Senator Thune said, eliminating some of these sort of preposterous, no-relation-to-the-budget, messaging amendments. At least have notice "what the hell" everything is that is up for amendment. I mean, if you are going to come up with a nutty amendment, you can come up with it just as easy 4 days before or 3 days before as you can on the day in question, and then at least everybody knows that when they read the title of the bill and it gets called up, the text of the bill might actually correlate or not correlate with the title of the bill. And you have a chance to sort of ward off some of the worst stuff.

It is tough to define germaneness around here, particularly when you drop a number in and suddenly it appears to be germane to the budget. But we should be trying to find a way so that stuff that has nothing to do with the budget, fine, have those fights, have them on another vehicle. The budget process is too important. Everything has become captive to the proxy wars and the messaging battles.

You know, even if we just focus on something as narrow as trying to make vote-a-rama less degrading a legislative exercise, it is a start. But I really think that—I would disagree with all of you. I think that there is more of a role for, as you said, Dr. Fisher, executive leadership. I do not see how you can see we need more ex-

ecutive leadership around here but not support it with any process changes. This is a process town. And if the White House does not have to be engaged, then they are not going to be. And I do not buy your assertion that because the budgets that come up are irresponsible that does not mean the President should have a role. Every Governor in every State games their budget, and they strip out of it all the stuff that they know that the legislature is going to put back in anyway so it gives them room to bring in a lower budget, and everybody knows it is fun and games and that it is phony to that extent. And then you go through the process of working your way through to an ultimate budget.

But the fact that there is phoniness in executive budgets at the State and the national level to me is no argument at all against trying to improve the role of the executive branch in our process so that they are more bought into it and there is a little bit more reality and heft to it.

Right now, as you say, the President's budget often comes up as a ridiculous charade. Then we go through our ridiculous charade, which culminates in the ridiculous charade of vote-a-rama. And, you know, you kind of wait for the grownup moment to come, and I just cannot help but believe that more engagement between the branches would be better for creating those adult moments than less.

And, again, I will echo what Senator Thune said. The status quo is not acceptable, so if you do not think that our proposals are good, help us out. Give us some other ones.

I thank the Chairman and I thank the Ranking Member.

Chairman CONRAD. Thanks Senator Whitehouse. You know, so many of your observations I think are just dead on.

I have been here 25—I started out on this Committee at the end of the table, and I am going to be leaving here next year. I want to leave this a better, more functional operation. And this is not working. It just is not working. I do not know what could be more clear. And unless we create more incentives for the process to work, then I think we have got a very serious challenge.

So I think we have had two very good hearings, and we have had lots of good discussions with the members of the Committee. I am going to be checking with the special committee to find out what is the drop-dead deadline. We have been given a deadline of the 14th. I talked to the Ranking Member about this. I am not sure that is the actual drop-dead date, but it may be. And we are exchanging drafts between us. We have not reached a conclusion. We are listening. We are listening to our colleagues. We are listening at these hearings. And I can tell you, this has been, I think, a very, very good hearing. I may not agree with you individually or collectively on your recommendations, but I will tell you one thing, you have certainly provided a lot of food for thought, and it is good thought. It is based on lifetimes of experience, and I think you made some very, very important points here today for the Committee.

Senator Sessions.

Senator SESSIONS. Thank you very much, Mr. Chairman.

I thought the meeting you called recently where we all sat around and were free to talk in a less structured way was very

good. My interpretation of it was that all of our members favored a 2-year budget. And I believe they included within that 2 years appropriations.

We know that some of the appropriators may not agree with that, but I do not believe all disagree, because when I was working with Pete Domenici, he was an appropriator and on the Committee. I discovered—I ran the numbers. We had half of the Republican—more than half of the Republican members of the Appropriations Committee supported it. That included 2-year appropriations.

Okay, so then we have got the vote-a-rama problem. We are having a dispute over minority rights that blew up the other week, and that has caused a lot of tension. I think we will work through that. Senator Reid has indicated he wants to listen. He called me and just wanted to talk about it. So I think maybe we can get past that, and then we will have to deal with how we want to—what rights you want to provide the minority to offer amendments and how that could be altered. The Chairman has made some good suggestions in that regard.

So I hope, Mr. Chairman, that we could reach an accord and get something out of here. Ultimately the 12 will have to evaluate whatever we recommend. They have already gotten recommendations concerning a biennial budget from others who offered legislation. So we might as well give our best judgment as to how it ought to be executed, if at all.

I thank each of you for your testimony, and our problem at this point in history is exacerbated by a fairly honest, respectable disagreement about the nature of the Republic of which we are a part.

Thank you.

Chairman CONRAD. The Senator, as always, is clear, and I think he has been very constructive in this discussion we have been having. I would propose to him at this point, I think what we should do is see if we can agree on a draft and then either reconvene the members of the Committee or circulate the draft for comment or perhaps some combination thereof. We can talk about that, but that is my thinking at the moment, that the Ranking Member and I should see if we can agree on a draft that we then circulate to the members, and then we either have a follow-up meeting to give them a chance to express themselves, or at the very least give them a chance to respond in writing. But I am kind of leaning toward having another meeting if we have the time given this deadline that we have been given.

Again, I want to thank the witnesses. We appreciate your testimony very much. The Committee will stand down.

[Whereupon, at 11:04 a.m., the Committee was adjourned.]

Questions for the Record
from Senator John Thune
for Dr. Louis Fisher, Dr. Phil Joyce and Dr. Paul Posner
"Improving the Congressional Budget Process"
October 11, 2011
Senate Budget Committee

Question #1:

Do you believe that the discretionary spending limits enacted in the *Budget Control Act of 2011* result in the President submitting a more responsible budget to Congress each year? Or, does the fact that entitlements are exempt from the spending limits enacted in the *Budget Control Act of 2011* make it less likely that the President will submit a responsible budget to the Congress?

ECONOMIC EFFECTS OF FISCAL POLICY CHOICES

TUESDAY, NOVEMBER 15, 2011

COMMITTEE ON THE BUDGET,
U.S. SENATE,
Washington, DC.

The Committee met, pursuant to notice, at 10:01 a.m., in Room SD–608, Dirksen Senate Office Building, Hon. Kent Conrad, Chairman of the Committee, presiding.

Present: Senators Conrad, Wyden, Nelson, Whitehouse, Merkley, Begich, Coons, Sessions, Crapo, Thune, and Johnson.

Staff Present: Mary Ann Naylor, Majority Staff Director; and Marcus Peacock, Minority Staff Director.

OPENING STATEMENT OF CHAIRMAN CONRAD

Chairman CONRAD. The hearing will come to order.

I want to welcome everyone to the Senate Budget Committee today, particularly our witness, Congressional Budget Office Director Douglas Elmendorf. Thank you very much for being here. Thank you for your good work.

In today's hearing we will again focus on the economy and steps that can be taken to strengthen the recovery and create jobs. Last year, at my request the Congressional Budget Office completed an analysis of the so-called bang for the buck achieved by different fiscal policy proposals. CBO has now updated that work, so we thought it would be useful to have Director Elmendorf here today to report on his agency's latest conclusions. I am hopeful that Congress will consider CBO's analysis in developing any near-term economic growth measures that might be passed before the end of the year.

I would like to begin by briefly reviewing the economic situation now confronting the Nation. It is clear that the economic recovery that we are now experiencing is not what it should be or what we would like it to be. Here are some of the factors, I believe, that are holding back the economy. Unemployment remains stubbornly high. The housing crisis that helped spark the downturn is continuing. We have weak consumer confidence and weak consumer demand. Personal debt is still near record levels. Businesses and consumers still face tightened borrowing standards. State and local budget cutbacks are continuing to create a drag on job and economic growth. And our debt is also a challenge to future economic growth.

Among these factors, the continuing housing crisis is particularly notable. If we look back at the seven previous recoveries, we can

see that a surging housing market was a driving force behind the return to economic growth. Housing starts rose dramatically in every one of those recoveries. But in this recovery, housing starts have remained low and continue to be.

We know that some of the drag holding back the recovery is caused by the nature of the recession that preceded it. Economists have found that, following recessions caused by or accompanied by a severe financial crisis, recoveries tend to be shallower and take much longer. Two leading economists, Dr. Carmen Reinhart and Dr. Vincent Reinhart, found in their research, and I quote from their findings:

"Real per capita GDP growth rates are significantly lower during the decade following severe financial crises. . . . In the 10-year window following severe financial crises, unemployment rates are significantly higher than in the decade that preceded the crisis. The decade of relative prosperity prior to the fall was importantly fueled by an expansion in credit and rising leverage that spans about 10 years; it is followed by a lengthy period of retrenchment that most often only begins after the crisis and lasts almost as long as the credit surge."

In other words, we could see a period of low growth and relatively high unemployment for some time because we are recovering from a severe financial crisis, the most severe since the Great Depression.

If we look at private sector job growth, we see it has improved dramatically from where we were in the recession. In January of 2009, the economy lost more than 800,000 private sector jobs in 1 month. Private sector job growth returned in March of 2010, and we have now had 20 consecutive quarters of growth—or 20 consecutive months of growth. However, clearly we have to do better. We need considerably more job growth in order to fuel a stronger recovery. The unemployment rate remains far too high. As of October, the unemployment rate was still hovering at 9 percent.

Although the recovery is not as strong as we would like, it is important to recognize our economic situation would be much worse if we had not had the Federal response to the recession and the financial crisis, including both the Fed's monetary policy action and the fiscal policy actions taken by Congress and the administration. That Federal response, I believe, pulled the economy back from the brink and likely prevented us from slipping into a depression. And it may not have been slipping into a depression. We may have gone head first into a depression.

Two other leading economists—Dr. Mark Zandi, who was an advisor to the McCain Presidential campaign, and Dr. Alan Blinder, former Vice Chairman of the Federal Reserve—completed a study last year that measured the impact of Federal actions on shoring up the economy. Here is a key quote from their report:

"We find that its effects on real GDP, jobs, and inflation are huge and probably averted what could have been called Depression 2.0. When all is said and done, the financial and fiscal policies will have cost taxpayers a substantial sum, but not nearly as much as most had feared and not nearly as much as if policymakers had not acted at all. If the comprehensive policy responses saved the econ-

omy from another depression, as we estimate, they were well worth their cost."

This next chart shows Dr. Zandi and Dr. Blinder's estimate of the number of jobs we would have had without the Federal response. It shows that we would have had 8.1 million fewer jobs in the second quarter of 2010 if we had not had the Federal response. We see a similar picture in the unemployment rate. According to Dr. Zandi and Dr. Blinder's findings, if we had not had the Federal response, the unemployment rate would have been 15 percent in the second quarter of 2010 and would have continued rising to 16.2 percent in the fourth quarter of 2010.

Looking forward, it is clear there are further steps that can be taken to help shore up the recovery in the near term. CBO's analysis looks at some of these steps and determines which would provide the greatest bang for the buck in spurring economic growth and job creation. Here are CBO's key findings:

On the upper end of the scale, it shows that policies like extending unemployment insurance and an employer payroll tax cut give you a higher impact on GDP for each dollar spent.

On the bottom end of the scale, CBO once again found that extending the Bush era tax cuts provide a much lower impact on GDP for each dollar spent.

It also found that a repatriation tax holiday provides very little bang for the buck.

I look forward to hearing more about these findings from Director Elmendorf.

To be clear, there is nothing contradictory about pursuing near-term economic growth measures at the same time we pursue long-term debt reduction. We can and we must do both. We need to a give a near-term boost to the recovery while simultaneously putting in place policies that will bring down deficit and debt over the long term. The deficit reduction can be phased in after the recovery is on a stronger footing, but it should be enacted into law now.

I want to be very clear about this. On every group that I have served, whether it is the Fiscal Commission or the Group of Six, we adopted that basic strategy, that it is clear we must put into law now a long-term deficit reduction plan. I believe that would provide a significant boost in confidence in the markets as people see the Government finally putting its fiscal house in order.

With that, we will now turn to Senator Sessions for his opening remarks.

OPENING STATEMENT OF SENATOR SESSIONS

Senator SESSIONS. Thank you, Mr. Chairman, and thank you, Director Elmendorf. We respect the work that you do, and we rely on it, but I am not unaware, just re-reading recently Alan Greenspan's testimony before this Committee, quoting CBO numbers in 2001, projecting 30 years of surpluses and that we would pay down the entire debt of the United States of America, and he wondered what to do with the surplus. So we have been wrong before. You predicted 3.1 percent growth this year. It is going to come in at probably half that. Dr. Zandi predicted 3.9 percent growth this year. Now they revise that, I think Moody's Analytics, to 1.6 percent.

I do not agree, Mr. Chairman, that there is no contradiction between borrowing and taxing to spend today and the problems that have gotten this country into the fix we are in. As I see it, we are in a long-term financial difficulty as a result of debt: We have excessive debt throughout the system. The Government has assumed huge amounts of private debt. And I agree, we have got a 10-year, or more maybe, deleveraging process to go through, and we are just not going to see the growth that we would like to see until that is through.

So I would oppose adding more debt. I think nothing could be more simpler, nothing could be more basic. And under the plan that the President has proposed, $450 billion in borrowing and spending in the near term, plus a $450 billion tax increase, I do not believe that that is going to be a 10-year benefit to the economy. And I would be delighted to hear your view of it, Mr. Elmendorf. And I do appreciate the fact that you predicted, when we passed the first $800 billion stimulus package, you predicated that in the short run there would be some benefit, but over 10 years you predicted there would be a net negative, because there is a reality of debt out there that just cannot be wished away. All of that was borrowed. All of that added to our debt. And I am sure you would agree that after the 10 years, since we paid none of that, we will have paid none of that down, that it will continue to be a drag on the economy for decades to come, long after the short-term sugar high we may have achieved as a result of it.

So I am very concerned about where we are going. I am concerned, Mr. Chairman, about the Committee of 12. Mr. Zandi told us just a few weeks ago we had to have $4 trillion in reduced deficit. Four trillion, he said, at an absolute minimum, as has every other witness, as you have said. And I am not aware that they are moving toward that kind of agreement. We are still in denial, it seems to me. So if we have learned nothing else from the financial crisis in 2008, it is that prosperity cannot be built on a foundation of debt. Excessive debt, public and private, provided the air that pumped into the economy that resulted in the burst bubble. Surely we know debt is not the solution, not more debt. And if there is a second lesson we should have learned, it is a healthy skepticism for Washington elites. Many of the same people who fell asleep at the switch before the housing bubble, did not see it coming, are not urging us to create more debt in the Government, a Government bubble. I call them, affectionately sometimes, "Masters of the Universe." They are quick to make confident predictions and even quicker to explain why the failure of their last prediction should not count against the one they are just making today. They say mammoth stimulus failed because it was not big enough, or that the explosion in regulation helped the economy. We need more regulation, they say. Advocates for more stimulus frequently cite CBO's economic models, but CBO projected a long-term negative growth.

In 2009, CBO stated in your report—and it certainly appears that you have been correct—"The increased debt will tend to reduce the stock of productive capital. In economic parlance, the debt will crowd out private investment." CBO's projections were that—your projections also are that reducing the deficit by $2 trillion would

eventually boost economic growth by 0.5 to 1.4 percent, so that is a good sign. That tells us what we need to be doing, which is reducing debt.

So we need a long-term plan. In a time of crisis, confusion and fear, we should return to basic core principles, the tried and true: Pay your debts, spend within your means, and instead of asking the taxpayers for a bailout, Washington must end the dishonest accounting and waste and abuse that we have in our country.

What we need is a middle-class agenda. That means creating jobs through the private sector, producing more American energy, making the Government lean and productive, confronting our dangerously rising debt, adopting a globally competitive Tax Code, upholding the rule of law and trade, commerce, and immigration, and, finally, delivering the good people of this country the honest and responsible budget they deserve and have not had in over 900 days.

Thank you, Mr. Chairman.

Chairman CONRAD. Thank you.

Two quick things I would say. We may have a disagreement about the short term, but we have an agreement about the long term. The debt is the threat. It would be, I think, a huge boost for this country, I think it would be a boost globally if the Special Committee came back with a 10-year plan that reduced the deficits in the range of $4 trillion. I tried to convince the Fiscal Commission to do $6 trillion over 10 years. We could have balanced the budget with that size of a deficit adjustment and debt adjustment. And it is not that hard to do. You know, I think some people think this is so hard to do it is impossible.

Senator SESSIONS. It is not impossible.

Chairman CONRAD. I showed our colleagues one plan that I did that if you added 6 percent to the revenue that we project now and reduced expenditures 6 percent, you would save $6 trillion over 10 years. I call that the 6-percent solution.

Now, we could have a debate and we can have a discussion about what the mix should be, revenue and spending. Maybe some people want to do it all spending; maybe some people want to do it all revenue. Maybe some people want to do it 2:1 or 3:1, spending to revenue. To me, the real issue is: How do we find a way to come together to get the job done? It is a serious obligation.

Let me just say on the question of not having a budget, we passed the Budget Control Act. The Budget Control Act provides a budget for this year and next. We may not like it, but that is the law. It is the law of the land. The Budget Control Act passed, signed by the President. It lays out the budget for this year and next year. And it provided for this Special Committee that is, in effect, the reconciliation process, clear and simple.

So we have got a budget. We may not particularly like it or particularly agree with it, but we have got one. And we got it in the Budget Control Act.

Senator SESSIONS. Mr. Chairman?

Chairman CONRAD. Yes, sir.

Senator SESSIONS. Just to follow up on part of what you were saying, you quoted, I believe, Rogoff and Reinhart about this being——

Chairman CONRAD. Reinhart and Reinhart.

Senator SESSIONS. Reinhart and Reinhart.

Chairman CONRAD. The other is a different one.

Senator SESSIONS. This being a financial crisis takes a longer term. I think that is a little bit of a misconception to most hearers. They think financial crisis means a bank crisis. But, really, it means a debt financial crisis. In other words, people at the time this bubble burst were saving nothing in the United States. We were actually drawing down our savings, which is really unprecedented in our history. So individuals had great personal debt. The Government is now running for the third consecutive year trillion-dollar debts, and we have taken over huge mortgage problems and liabilities from banks and assumed that on the public sector. So it is a simple thing. You either default on your debt, which has immediate short term painful ramifications, or you somehow carry the debt over a longer period of time and try to pay it off and reduce it. And the problem is that when you do that, it is a depressant on the economy. Money is being spent not to consume, buy, or purchase, but money is being consumed to pay down debt—or pay interest on the debt. We are not close to paying down the debt as of today.

So I guess I acknowledge and I think we all need to understand that we are going to be in a long-term effort to move ourselves out of this deleveraging period, and the first thing you should do is not add more to the debt and acknowledge it is going to be a tough period of time. Then we need to do everything possible that helps working Americans be successful by creating a climate for long-term growth.

We can all disagree—and we will agree on a lot of how to do that, but that is where I am on it. I think that is where most of the American people are. And I look forward to hearing Mr. Elmendorf. Thank you.

Chairman CONRAD. Let me just say with respect to the Reinhart study, when they are talking about financial crisis, they are talking about not only the circumstance of individual States but also damage to the financial institutions, including private sector institutions. When you have that kind of dramatic break in the financial markets and damage to the balance sheets of the major lending institutions, that has an effect on credit going forward.

So what they found is that when you have an explosion of credit, as we did before this downturn, in part fueled by Federal Reserve policy, interest rates kept abnormally low for an extended period, fiscal policy, very loose fiscal policy under the control of Congress and the administration—we were running massive deficits even then. That combination, I believe, coupled with a lack of regulation of derivatives and the explosion of AIG did enormous damage to the financial structures, both private and public, and exploded debt, both public and private. And the result is you have got financial institutions with impaired balance sheets, which means they cannot extend credit in the same way they normally would. And that is what they find in their study.

First you have a credit bubble, usually 10 years in duration, and then you have a recovery about the same period of time. So, you know, we have cooked a real stew. We have cooked a real stew.

Senator SESSIONS. You are right, and I guess I will—I think we both can join together and say this is not going to be an easy fix. There is no quick fix out there. And how we handle it, we will all have to work together and do what is best for the country. I just believe that the quick-fix days are over, and as one of our witnesses said not long ago, you get the stimulus benefit from spending today, and it is maybe a year or two benefit. But if you are in a period of a decade working your way out of this economic difficulty, then the hit hits you before the 10 years is up, before you are out of the recovery.

So that is why I do not think we can any longer continue to short-term sugar high stimulus spend and create more debt, because it is simply going to catch us before the 10 years is up. And we need to have an honest long-term plan. The President needs to be far more honest with the American people about how difficult this is, and do it in a long-term view, not a short-term view.

Thank you.

Chairman CONRAD. The place you and I agree—we clearly have a disagreement short term. The place we have agreement is longer term, and somehow collectively we have got to find a way to be successful here in changing course. When we are borrowing 40 cents of every dollar, revenue the lowest it has been in 60 years, spending the highest it has been in 60 years, certainly I think we can agree we have got a serious problem, and we have got a collective responsibility to dig out of it.

Director Elmendorf, I apologize for this early discussion, but I think it is important to have. Please proceed with your testimony, and then we will go to questions.

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

Mr. ELMENDORF. Thank you, Chairman Conrad and Senator Sessions and to all the members of the Committee. I appreciate the invitation to testify today about the outlook for the economy and policy options for increasing output and employment during the next few years.

As you know, the U.S. economy has struggled to recover from the deep recession. Although total output started to expand more than 2 years ago, the pace of the recovery has been very slow compared with the average recovery since World War II, and the economy remains in a severe slump.

We expect that, under current law, growth and output will remain slow, and as a result, job gains will be limited, leaving the unemployment rate close to 9 percent through the end of 2012.

Given CBO's outlook for the economy, which is similar to that of many private forecasters, a large portion of the economic and human costs of this downturn remain ahead of us. We think the economy is only about halfway through the cumulative shortfall in output relative to the potential level that could be achieved if our labor and capital were more fully employed. The costs of that shortfall are immense in total, and they fall disproportionately on people who lose their jobs, who are displaced from their homes, or who own businesses that fail.

Concerns about the weak economic recovery have prompted the consideration of fiscal policy actions to spur economic growth and increase employment during the next few years. CBO assessed the cost-effectiveness in boosting the economy of a variety of possible changes in tax and spending policies.

Figure 1 from the testimony, reproduced on the back of a single piece of paper in front of you, summarizes our findings. The figure shows the estimated impact on years of full-time equivalent employment in 2012 and 2013 per million dollars of budgetary cost.

To be sure, this measure of cost-effectiveness is only one of the criteria that might be applied in evaluating policies. Other criteria are discussed in the written testimony. For each policy, we show a range of estimates reflecting the uncertainty that accompanies any analysis of this sort.

The policies that we estimate would have the largest effects on employment in 2012 and 2013 per dollar of budgetary cost are policies that would be targeted toward people who would be most likely to spend the additional income, such as increasing age of the unemployed shown in the top bar in the figure, or providing additional refundable tax credits for lower- and middle-income households, the next bar down, or policies that would reduce the incremental cost to businesses of adding employees, such as reducing employers' payroll taxes, which is the top bar in the second bank, or reducing employers' payroll taxes only for firms that are increasing their payroll, which is the bar below that.

The policies that we estimate would have the smallest effects on employment in 2012 and 2013 per dollar of budgetary cost are policies that would affect businesses' cash flow, but would have little impact on their incremental incentives to hire or invest. Examples include reducing taxes on business income and reducing taxes on repatriated foreign earnings, shown in the bottom two bars in the middle bank.

Despite the near-term economic benefits that would arise from reductions in taxes and increases in Government spending, such actions would add to the already large projected budget deficits. Unless offsetting actions were taken to reverse the accumulation of additional debt, the Nation's future output and income would be lower than they otherwise would have been. If policymakers wanted to boost the economy in the near term while also achieving long-term fiscal sustainability, a combination of policies would be needed, namely, changes in taxes and spending that would widen the deficit now but reduce it later in the decade.

Such an approach would work best if the future policy changes were sufficiently specific and widely supported so that households, businesses, and participants in financial markets believe that the future fiscal restraint would truly take effect.

Lawmakers could also influence economic growth and employment during the next few years by changing policies apart from taxation and Government spending. For example, legislation could modify existing or proposed regulations, alter the Government's role in a particular sector of the economy, or change trade relationships with other countries. The near-term economic impact of such changes would depend on how the affected businesses' investment and hiring decisions, households' purchasing power and wealth,

and, importantly, expectations and uncertainty about future Government policies and economic conditions.

CBO considered some potential changes in policies related to energy and the environment, the financial and health care sectors, and international trade. But there are few analytic tools for estimating the near-term effects on overall economic activity of such changes, so we did not attempt to quantify the effects of those potential changes with any precision.

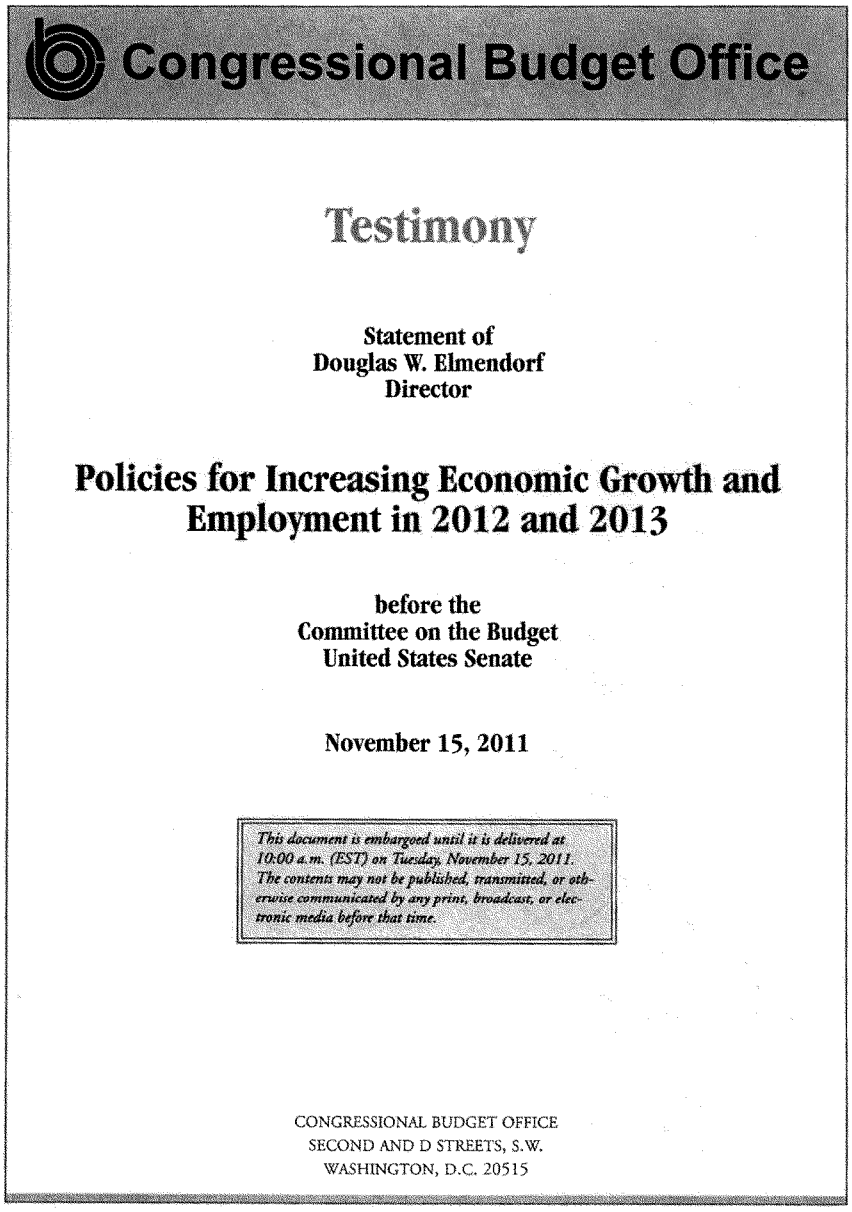
In our judgment, however, the effects of the specific changes in regulatory policies or other policies apart from fiscal policies that we considered probably would be too small or would affect the economy too slowly to make an important difference in overall output or employment during the next 2 years.

I should emphasize that the policy changes of this sort that we examined are illustrative rather than exhaustive. Many other changes which might have larger or smaller economic effects are possible.

Moreover, our analysis does not address other critical considerations in evaluating such policy changes, including the long-term effects on the economy, on people's health, and on the environment.

Thank you. I am happy to try to answer any questions you have.

[The prepared statement of Mr. Elmendorf follows:]



Congressional Budget Office

Testimony

Statement of
Douglas W. Elmendorf
Director

Policies for Increasing Economic Growth and Employment in 2012 and 2013

before the
Committee on the Budget
United States Senate

November 15, 2011

This document is embargoed until it is delivered at 10:00 a.m. (EST) on Tuesday, November 15, 2011. The contents may not be published, transmitted, or otherwise communicated by any print, broadcast, or electronic media before that time.

CONGRESSIONAL BUDGET OFFICE
SECOND AND D STREETS, S.W.
WASHINGTON, D.C. 20515

Chairman Conrad, Senator Sessions, and Members of the Committee, thank you for inviting me to testify on the outlook for the economy and policy options for boosting economic output and employment during the next few years.

Summary

The U.S. economy has struggled to recover from the deep recession that began in December 2007 and ended in June 2009. Although total output started to expand again more than two years ago, the pace of the recovery in output and employment has been slow compared with the average recovery since World War II, and the economy remains in a severe slump. The Congressional Budget Office (CBO) expects that, under current law, economic growth will continue to be slow and real (inflation-adjusted) gross domestic product (GDP) will stay well below the economy's potential—a level that corresponds to a high rate of use of labor and capital—for several years. As a result, a large portion of the economic and human costs of the recession and slow recovery remains ahead. Those costs fall disproportionately on people who lose their jobs, who are displaced from their homes, or who own businesses that fail.

The slow recovery of output and employment largely reflects the nature of the recession. The collapse of house prices and the financial crisis—conditions unlike anything this country has seen since the Great Depression—pushed the economy into a deep recession. In the aftermath of such a crisis, it takes time for households to rebuild their wealth and pay down their debts, for financial institutions to restore their capital bases and the supply of credit, and for businesses to regain the confidence necessary to invest in new facilities and equipment.

CBO expects real GDP to grow in the vicinity of 1½ percent this calendar year (as measured by the change between the fourth quarter of 2010 and the fourth quarter of 2011) and around 2½ percent next year. With modest growth in output, CBO expects employment to expand very slowly during the rest of this year and next year, leaving the unemployment rate close to 9 percent through the end of 2012. Weakness in the demand for goods and services is the principal restraint on hiring, but structural impediments in the labor market—such as a mismatch between the requirements of existing job openings and the characteristics of job seekers (including their skills and geographic location)—appear to be restraining hiring as well.

So that CBO's projections can serve as a benchmark for assessing the impact of legislative proposals, the agency's economic forecast reflects the provisions of current law. Under current law, the expiration of tax cuts and constraints imposed by the recently enacted Budget Control Act of 2011 (Public Law 112-25)—along with automatic changes in the budget as the economy grows (namely, higher tax revenues and lower spending for some income support programs)—will cause federal fiscal policy to significantly restrain economic growth in 2012 and 2013.

Concerns that the economic recovery will continue to be slow and protracted have prompted the consideration of fiscal policy actions to spur economic growth and increase employment during the next few years. Three key criteria for evaluating such actions are:

- Timing—providing help when it is needed;
- Cost-effectiveness—generating a large amount of additional output and employment per dollar cost to the federal budget; and
- Consistency with long-term fiscal objectives—not worsening the long-run budget outlook.

Other considerations include who would be helped the most by the policy; what would be the value to society of any additional goods and services produced; and how uncertain would the outcomes be.[1]

This testimony assesses the potential impact of a variety of temporary fiscal policy actions that might be considered to promote economic growth and increase employment in the near term. CBO estimates that the policies analyzed here would raise real GDP in 2012 and 2013 by an amount ranging from as little as 10 cents per dollar of budgetary cost to as much as $1.90 per dollar of budgetary cost; the impact of the policies on employment would range from a marginal increase to an increase of as much as 19 years of full-time-equivalent (FTE) employment per million dollars of budgetary cost over that two-year span (see Figure 1). Thus, changes in fiscal policy, if appropriately designed, would promote economic growth and increase employment during the next few years.

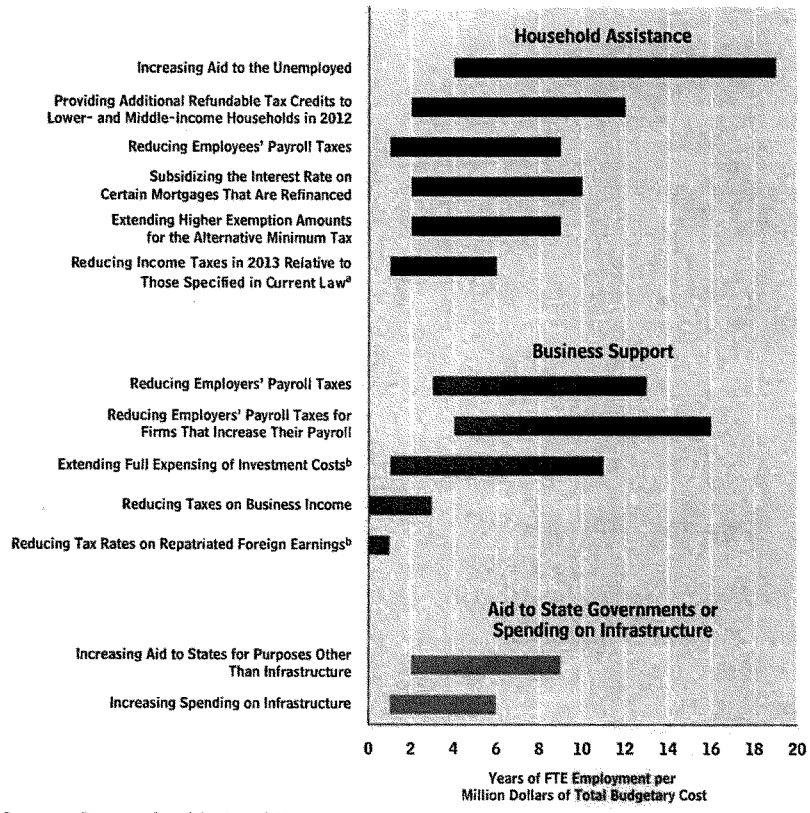
Comparing the estimated effects of different policy actions shows the following:

- Policies that would have the largest effects on output and employment per dollar of budgetary cost in 2012 and 2013 are ones that would reduce the marginal cost to businesses of adding employees or that would be targeted toward people who would be most likely to spend the additional income. Such policies include reducing employers' payroll taxes (especially if limited to firms that increase their payroll), increasing aid to the unemployed, and providing additional refundable tax credits in 2012 for lower- and middle-income households.
- Policies that would primarily affect businesses' cash flow but would have little impact on their marginal incentives to hire or invest would have only small effects. Such policies include reducing business income taxes and reducing tax rates on repatriated foreign earnings.

1. See Congressional Budget Office, *Options for Responding to Short-Term Economic Weakness* (January 2008); and the Statement of Douglas W. Elmendorf, Director, Congressional Budget Office, before the House Committee on the Budget, *The State of the Economy and Issues in Developing an Effective Policy Response* (January 27, 2009).

Figure 1.

Ranges of Cumulative Effects of Policy Options on Employment in 2012 and 2013



Source: Congressional Budget Office.

Notes: The ranges of estimates were chosen, on a judgmental basis, to encompass most economists' views.

Estimates represent years of full-time-equivalent employment (FTE-years) with a given policy minus FTE-years without the policy. (An FTE-year is 40 hours of employment per week for one year.) Estimates are per million dollars of total budgetary cost, which is the amount of tax revenues or outlays over the full duration of a policy's effects, except as specified in note b below.

All years are calendar years. Unless otherwise specified, increased spending authority is assumed to be available as of January 2012, and tax options are assumed to be in effect only for 2012.

a. Includes the effects of extending higher exemption amounts for the alternative minimum tax in 2012.

b. For this option, total budgetary cost is calculated as a discounted present value rather than as the sum of changes in tax revenues over the full duration of the policy's effects.

Despite the near-term economic benefits that would arise from reductions in taxes and increases in government spending, such actions would add to the already large projected budget deficits, either immediately or over time. Unless offsetting actions were taken to reverse the accumulation of additional government debt, the nation's capital stock, its future output, and people's future incomes would tend to be lower than they otherwise would have been. If policymakers wanted to boost the economy in the near term while seeking to achieve long-term fiscal sustainability, a combination of policies would be required: changes in taxes and spending that would widen the deficit now but reduce it later in the decade. Such an approach would work best if the future policy changes were sufficiently specific and widely supported so that households, businesses, state and local governments, and participants in financial markets believed that the future fiscal restraint would truly take effect.

Lawmakers could also influence economic growth and employment during the next few years by changing policies that do not involve, or whose scope extends well beyond, taxation and government spending. For example, legislation could modify existing or proposed regulations, significantly alter the government's role in a particular sector of the economy, or change trade relationships with other countries. Other types of policy changes that do not require legislation, such as those related to monetary policy or those that can be implemented by federal agencies under current law, could also affect economic activity, but they are outside the scope of this testimony.

The near-term economic impact of changing a regulation or other policy apart from fiscal policy would depend importantly on how doing so affected businesses' investment and hiring decisions. In addition, changes in policies that increased or decreased households' purchasing power or wealth would influence how much they spend. Moreover, changes to regulations and other policies could affect expectations about future income or make businesses and households more or less uncertain about future government policies and economic conditions, which would affect economic growth and employment in the near term.

This testimony discusses some potential changes in regulatory policies and other policies related to energy and the environment, the financial and health care sectors, and international trade. But estimating the near-term effects on overall economic activity of such policy changes is exceedingly difficult, and few analytic tools are available for that purpose. Accordingly, CBO did not attempt to quantify the effects of those potential changes with any precision.

Some changes in policies that CBO considered would probably raise output and employment during the next few years; other changes would probably lower output and employment; and some changes would have effects on economic activity whose sign is difficult to determine. However, in CBO's judgment, the economic effects of the specific changes in regulatory policies or other policies apart from fiscal policies that are discussed in this testimony probably would be too small or would occur too slowly to significantly alter overall output or employment in the next two years. (The policy changes examined here are illustrative rather than exhaustive; many others,

which might have larger or smaller economic effects, are possible.) This testimony does not speak to other critical considerations in evaluating such policy changes, including the long-term effects on the economy, on people's health, and on the environment.

The Economic Outlook

The U.S. economy has struggled to recover from the deep recession that, according to the National Bureau of Economic Research, began in December 2007 and ended in June 2009. Although total output started to expand again more than two years ago, the pace of the recovery in output and employment has been quite slow, and the economy remains in a severe slump. Real GDP in the third quarter of 2011 was about 5 percent below CBO's estimate of its potential—a level that corresponds to a high rate of use of labor and capital. By contrast, 2¼ years after the end of previous recessions since 1948 (except after the brief 1980 recession), real GDP was between 3.2 percent below and 3.8 percent above its potential. CBO expects that, under current law, economic growth will continue to be slow and real GDP will stay well below the economy's potential for several years (see Figure 2).

The Slow Recovery

Real GDP rose by 5.6 percent from the second quarter of 2009 through the third quarter of 2011, roughly retracing its 5.1 percent decline during the recession but falling well short of the average of 12.2 percent growth during the same span (the first nine quarters) in previous recoveries since the end of World War II (see Figure 3, top panel). The slow pace of the recovery is particularly unusual given the severity of the recession. It contrasts sharply with the vigorous recoveries that followed the deep recessions that began in 1973 and 1981; for example, after falling by 3.2 percent during the 1973–1975 recession, real GDP grew by almost 12 percent during the first nine quarters of the subsequent recovery.

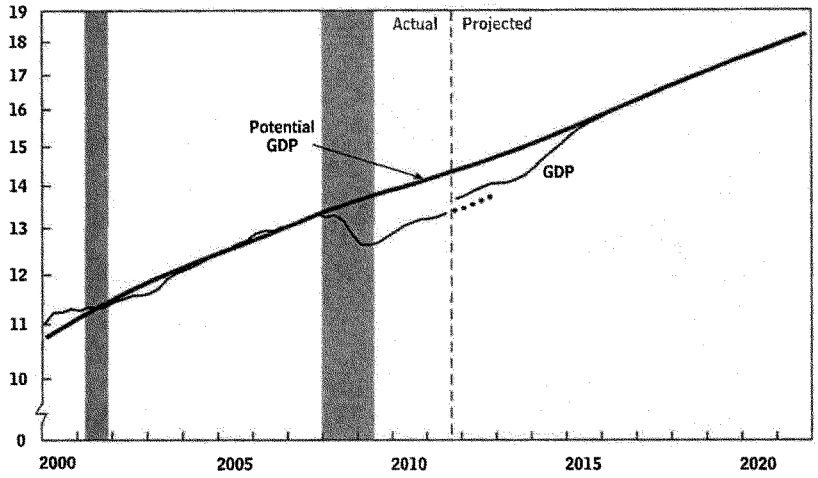
The modest growth of output can be traced in large part to a weak rebound in consumer spending and continued low levels of homebuilding. Consumer spending has increased more slowly in this recovery than it did, on average, following previous postwar recessions, even though it declined more than usual during the most recent recession. Real investment in residential structures (such as houses and apartment buildings) plunged from 2006 through mid-2009 and has edged down further since the end of the recession; in contrast, increases in such investment have played a key role in most past recoveries.

Gains in employment during the recovery have also been much weaker than might have been expected given the sharp drop in employment during the recession and the experience of previous recoveries. After falling by 7.5 million during the recession, employment increased by only about 1 million jobs (or 0.8 percent), on net, between June 2009 and October 2011. By contrast, employment rose by an average of 6.7 percent during the same span in past recoveries (see Figure 3, bottom panel). Moreover,

Figure 2.

Real Gross Domestic Product

(Trillions of 2005 dollars, logarithmic scale)



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

Notes: Real gross domestic product (GDP) is the output of the economy adjusted to remove the effects of inflation. Potential GDP is CBO's estimate of the output that the economy would produce with a high rate of use of its labor and capital resources.

Data are quarterly. Actual data for GDP, which are plotted through the third quarter of 2011, incorporate the July 2011 revisions of the national income and product accounts. The projections of GDP indicated by the solid line are taken from Congressional Budget Office, *The Budget and Economic Outlook: An Update* (August 2011). They are plotted through the fourth quarter of 2021 and are based on data issued before the revisions. The projections of GDP indicated by the dotted line incorporate the effects of the revisions and events since early July, when the previous forecast was completed; they are plotted through the fourth quarter of 2012.

Shaded vertical bars indicate periods of recession.

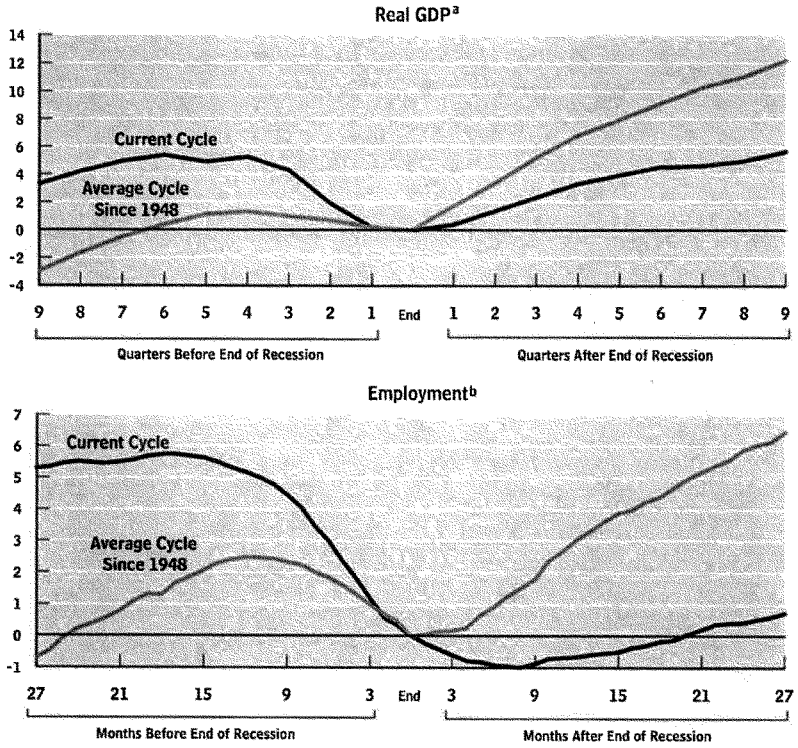
the growth of employment has slowed markedly during the past several months compared with its pace earlier in the year. The total number of jobs increased at an average monthly rate of about 180,000 in the first four months of this year, more than double the average pace in 2010 (see Figure 4); but from May through October, the number of jobs increased at an average monthly rate of only about 90,000.

Consequently, the unemployment rate has fallen by only a small amount. It climbed to 10.1 percent of the labor force in October 2009, approaching the 10.8 percent reached in November and December 1982 (which was the highest rate since 1948, when comparable data first became available), and is still at 9.0 percent (see Figure 5).

Figure 3.

Recovery in Real Gross Domestic Product and Employment

(Percentage difference from value at end of recession)



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

Note: The average cycle since 1948 excludes the 1980 cycle (because the subsequent quarters included another recession) and the current cycle.

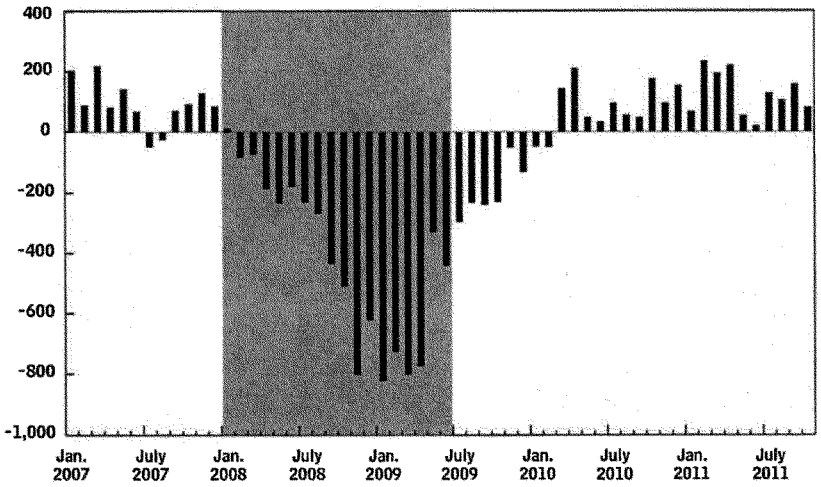
a. Real gross domestic product (GDP) is the output of the economy adjusted to remove the effects of inflation.

b. Employment comprises all nonfarm payroll employees. The data exclude temporary census workers in 1990, 2000, and 2010.

Figure 4.

Net Job Growth per Month

(Thousands of jobs)



Sources: Congressional Budget Office; Department of Labor, Bureau of Labor Statistics.

Notes: Data are monthly and are plotted through October 2011. They exclude temporary jobs associated with the 2010 census.

The shaded vertical bar indicates a period of recession.

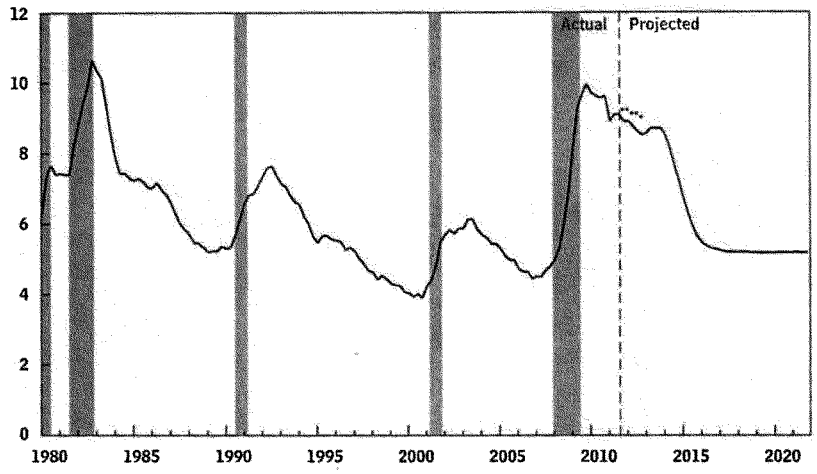
The unemployment rate would have been even higher during the past few years had the size of the labor force not fallen as much as it did. The decline in the labor force is partly owing to a marked rise in the number of unemployed workers who report dropping out of the labor force because they were discouraged about their job prospects. If those discouraged workers were counted as being in the labor force and unemployed, the unemployment rate in October would have been 9.6 percent rather than the actual 9.0 percent; in November 2007, before the recession, counting discouraged workers would have added only about 0.2 percentage points to the reported 4.7 percent unemployment rate.

The weakness of the recovery largely reflects the nature of the recession. An extraordinary surge in house prices and favorable borrowing conditions encouraged an unprecedented run-up in household debt and high levels of home construction and consumer spending relative to income by the mid-2000s. The subsequent plunge in house prices and the financial crisis—conditions unlike anything this country has seen since the Great Depression—pushed the economy into a deep recession. Despite the strong international evidence that recoveries following financial booms and busts

Figure 5.

Unemployment Rate

(Percent)



Sources: Congressional Budget Office; Department of Labor, Bureau of Labor Statistics.

Notes: The unemployment rate is a measure of the number of jobless people who are available for work and are actively seeking jobs, expressed as a percentage of the labor force.

Data are quarterly. Actual data are plotted through the third quarter of 2011. The projections indicated by the solid line are taken from Congressional Budget Office, *The Budget and Economic Outlook: An Update* (August 2011) and are plotted through the fourth quarter of 2021. The projections indicated by the dotted line incorporate the effects of events since early July, when the previous forecast was completed; they are plotted through the fourth quarter of 2012.

Shaded vertical bars indicate periods of recession.

tend to be very protracted, the importance of the various factors involved is unclear. For the United States today, the following factors appear to be playing some role:

- The large drop in household wealth before and during the recession and a desire by households to reduce their indebtedness, which is causing them to increase their saving and reduce their spending;

- Difficulty for some households and businesses in obtaining credit because lenders have imposed standards and terms for loans that are generally stricter than those in the years immediately before the recession and, in some instances, stricter even than those seen in prior years—leading potential borrowers to reduce their consumption and investment;

- A large glut of vacant homes, which has pushed the construction of new homes to the lowest levels since at least 1959;

- Uncertainty and worries about future economic activity and government policies in the United States and about the stability of the European financial system, leading households to spend less and businesses to undertake less investment and hiring;

- The very low level of the interest rate the Federal Reserve usually adjusts to implement monetary policy (the federal funds rate) and a reduced responsiveness of the economy to a decline in interest rates (because of the oversupply of vacant homes and the desire of households to lower their debt)—resulting in less ability for monetary policy to support economic growth; and

- A decreased share of national income going to the compensation of workers, which reduces consumer spending overall.

The Economic Outlook for 2011 and 2012

CBO expects the pace of economic recovery to remain modest for the next few years if current laws governing taxes and spending remain in effect. Growth slowed and inflation increased in the first half of 2011, in part because of developments that have proved temporary, including jumps in energy and food prices and disruptions to the global supply chain caused by the earthquake and nuclear accident in Japan. As the effects of those developments faded, the U.S. economy rebounded a little, supported by continued strength in business investment, small increases in consumer spending, and expansions in net exports (exports minus imports) and residential investment. Nevertheless, the pace of growth will probably be restrained for several more years by the lingering effects of the financial crisis and the recession and by the path of federal fiscal policy under current law.

Economic Growth and the Labor Market. CBO published its most recent economic forecast in August.[2] The agency initially completed that forecast in early July, and it updated its projections in August to reflect the policy changes enacted in the Budget Control Act of 2011 but no other developments. The news since CBO completed that work suggests that economic growth for the remainder of this year and next is likely to be weaker than the agency anticipated in that forecast—with growth in the vicinity of 1½ percent this calendar year (as measured by the change between the fourth quarter of 2010 and the fourth quarter of 2011) and around 2½ percent next year. Other forecasters have also modified their expectations. For example, between early July and early November, the *Blue Chip* consensus forecast (compiled from about 50 forecasts by private-sector economists) for real growth of GDP in 2011 was marked down from 2.6 percent to 1.6 percent. For 2012, the *Blue Chip* forecast was lowered from 3.0 percent to 2.3 percent.

2. See Congressional Budget Office, *The Budget and Economic Outlook: An Update* (August 2011).

CBO's projections reflect the agency's expectations of modest increases in spending by consumers, continued strong growth in investment by businesses, gains in net exports, and the beginning of a recovery in home construction. CBO expects consumer spending to improve in the near term as the temporary factors such as higher energy prices and supply disruptions fade further, as credit conditions improve more; and as households' net worth slowly increases. Strong growth in business investment will continue, CBO expects, as businesses expand capacity to meet increases in demand for their products. According to the agency's projections, residential construction will also increase in the near term. Still, with an unusually large number of vacant homes, CBO anticipates that it will take several years for the construction of new housing units to return to levels consistent with the growth of the population and the demand for replacement units.

The period since early July that has led many forecasters to lower their projections for near-term growth has included weakness in the financial markets, downward revisions to historical data on GDP, and diminished prospects for world economic growth. Stock prices, as measured by the value of the Standard & Poor's 500 index, fell by about 6 percent between early July and early November, returning to their level of early in the year. The annual revisions to the national income and product accounts and more recent data issued by the Commerce Department show that the economy was weaker from 2008 through mid-2011 than was previously thought. Furthermore, growth slowed in major foreign economies in mid-2011, and the near-term outlook for growth abroad has softened in light of the sovereign debt crisis in Europe.

With modest growth in U.S. output, CBO expects employment to expand very slowly during the rest of this year and next year. Weakness in the demand for goods and services is the principal constraint on hiring, but structural impediments in the labor market—such as a mismatch between the requirements of existing job openings and the characteristics of job seekers (including their skills and geographic location)—appear to be hindering hiring as well. As a result, the unemployment rate is likely to be around 9.0 percent through the fourth quarter of next year. (In CBO's August forecast, the unemployment rate fell to 8.5 percent by the fourth quarter of 2012.) Between early July and early November, the *Blue Chip* consensus similarly raised its forecast for the unemployment rate in the fourth quarter of 2012—from 8.1 percent to 8.9 percent.

Inflation and Interest Rates. Inflation increased markedly in the first half of 2011, spurred largely by a sharp rise in oil prices, but CBO projects that it will diminish in the second half of the year and be low in 2012. The increase in oil prices since late 2010 has been partly reversed, and trading in financial markets points to fairly steady prices for oil and other commodities in the next few years. In addition, the large amount of unused or underemployed resources in the economy will continue to hold down the growth of wages and prices.

CBO projects that the price index for personal consumption expenditures (PCE) will increase by about 2½ percent this year and by about 1½ percent next year (as mea-

sured by the change from the fourth quarter of the previous year). The "core" version of the PCE price index, which excludes prices for food and energy, is projected to rise by about 1¾ percent in 2011 and by about 1½ percent in 2012. The consumer price index for all urban consumers and its core version are expected to increase more rapidly than their PCE counterparts, especially in 2011. CBO currently expects inflation in 2011, as measured by both the PCE price index and the consumer price index, to be higher than the agency forecast in August because gasoline prices have remained high and inflation in housing rents has been higher than projected; expected higher inflation in rents accounts for the upward revision to CBO's outlook for inflation in 2012.

With modest inflation and slow economic growth, interest rates are likely to remain quite low through 2013. The interest rate on 3-month Treasury bills is likely to remain barely above zero, and as indicated by the financial markets, the rate on 10-year Treasury notes will probably remain less than 3½ percent.

The Output Gap and Its Costs

Economic growth at the rates CBO anticipates will leave a very large and persistent gap between actual output and the agency's estimate of potential output; that is, a large amount of labor and capital resources will be unused for some time. In CBO's August baseline projections, the output gap is about 5 percent of potential GDP at the end of 2011 and does not close fully until the second half of the 2011–2021 projection period.[3]

As a result, a large portion of the economic and human costs of the recession and slow recovery remains ahead. In mid-2011, according to CBO's estimates, the economy was only about halfway through the cumulative shortfall in output relative to its potential level that will result from the recession and the weak recovery. Between late 2007 and mid-2011, the cumulative difference between GDP and estimated potential GDP amounted to roughly $2½ trillion; by the time the nation's output rises back to its potential level, the cumulative shortfall is expected to equal about $5 trillion.

Not only are the costs associated with the output gap immense, but they are also borne unevenly. Those costs fall disproportionately on people who lose their jobs, who are displaced from their homes, or who own businesses that fail. In the first quarter of 2011, for example, the recession and weak recovery led to a shortfall of about 10 million jobs relative to the number that would have existed had the recession not occurred and had job growth matched the average rate in the previous business cycle. The unemployment rate has now exceeded 8.5 percent for 32 months, the longest such period since 1947, and the number of workers who are employed part time but want full-time work has averaged almost 9 million since early 2009, about double the number before the recession. Moreover, many of those who are unemployed have

3. CBO has not published new estimates of the paths for potential GDP and the output gap since August.

been out of work for a long time. In October, 42 percent of workers who were unemployed had been out of work for more than 26 weeks and about 30 percent for a year or more—rates of long-term unemployment that are unprecedented in the period following World War II. In addition, although the number of unemployed workers per job opening has fallen significantly since the end of the recession, it still remains much higher than at its peak following the 2001 recession, when the rebound in employment was also unusually slow. Even among workers who find new jobs, experience suggests that many will end up with lower earnings, not only in the short term but for many years to come.[4]

The underutilization of capital and labor resources also affects the federal budget. If the economy was operating at its potential, the projected federal deficit in fiscal year 2012 would be about a third lower, or roughly $630 billion (4.0 percent of GDP) instead of the $973 billion (6.2 percent of GDP) projected in CBO's most recent baseline.[5] If the economy was operating at its potential, people's incomes and federal revenues would be higher, while federal outlays for certain income support programs would be lower.

The Impact of Fiscal Policy

Under current law, federal fiscal policy has provided decreasing support for economic activity this year and will significantly restrain economic growth in 2012 and 2013.[6] One reason for that pattern is that the stimulative impact of the American Recovery and Reinvestment Act (ARRA, P.L. 111-5) is winding down. CBO estimates that relative to what would have happened without that law, ARRA raised real GDP by between 0.7 percent and 4.1 percent in 2010 but is raising GDP by a smaller amount in 2011 and will do so by even less in 2012.[7] ARRA's boost to employment is also diminishing. CBO estimates that the law raised employment (relative to what it would have been otherwise) by between 0.7 million and 3.3 million jobs in 2010, but the law's impact on employment will be progressively smaller in 2011 and 2012.

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4. For an analysis of the cost of losing a job in an economic downturn, see Congressional Budget Office, *Losing a Job During a Recession*, Issue Brief (April 2010).

5. See Congressional Budget Office, letter to the Honorable Chris Van Hollen providing CBO's estimate of the portion of the federal deficit that is due to the current underutilization of capital and labor resources in the economy (October 4, 2011).

6. Weak growth in outlays by state and local governments will also slow economic growth in those years, but that effect will be largely offset by slow growth in those governments' collections of tax revenues because of the modest recovery.

7. In estimating the effects of ARRA, CBO selected low and high estimates of the effects of each provision of the law; those estimates were chosen to encompass most economists' views about the effects of that type of provision. For a discussion of CBO's estimation methods, see Congressional Budget Office, *Estimated Impact of the American Recovery and Reinvestment Act on Employment and Economic Output April 2011 Through June 2011* (August 2011). The low ends of the ranges described here are smaller than those shown in CBO's August report, reflecting further analysis of the multiplier effects of changes in federal taxes and spending. CBO's next report on ARRA, which will be issued later this month, will incorporate those changes.

Economic support provided by federal fiscal policy is also decreasing because the effect of the government's so-called automatic fiscal stabilizers is declining as the economy continues to grow (albeit slowly). Those stabilizers are the automatic responses of revenues and outlays to cyclical movements in real GDP and unemployment. For example, when GDP falls relative to potential GDP during a recession, the reduction in income causes tax revenues to decrease automatically. In addition, some outlays—such as those for unemployment insurance and federal nutrition programs—increase because unemployment rises and more people experience reductions in income, qualifying them to enter existing programs. Those automatic responses provide fiscal support when economic activity slows and provide fiscal restraint when economic activity picks up.[8] Federal fiscal support from the automatic stabilizers equaled roughly 2½ percent of potential GDP in 2010, CBO estimates, but is likely to be smaller in 2011 and 2012.

In addition, economic support from fiscal policy will diminish as provisions of the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 (P.L. 111-312, referred to here as the 2010 tax act) expire as scheduled over the next two years and as the Budget Control Act is implemented. In particular:

- The 2010 tax act temporarily extended numerous tax cuts that were slated to expire at the end of 2010 and included new provisions that are also scheduled to expire within the next two years. For example, it continued through December 2012 various tax reductions enacted in the Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA) and the Jobs and Growth Tax Relief Reconciliation Act of 2003 (JGTRRA), and it extended through December 2011 provisions limiting the reach of the alternative minimum tax (AMT).[9] It also reduced the employee's share of the Social Security payroll tax in 2011, provided temporary tax incentives for business investment, and extended certain additional unemployment insurance benefits through January 3, 2012.

- The Budget Control Act set caps on discretionary appropriations that will reduce discretionary spending in real terms over time. It also created a Congressional Joint Select Committee on Deficit Reduction, whose stated goal is to propose further policy changes that would save at least $1.5 trillion over 10 years. If, by January 15, 2012, legislation originating from that committee and projected to achieve at least $1.2 trillion in deficit reduction over the next 10 years is not enacted, automatic procedures established by the new law will reduce spending between fiscal years 2013 and 2021 by the difference between $1.2 trillion and any savings that are

8. For more information about automatic fiscal stabilizers, see Congressional Budget Office, *The Effects of Automatic Stabilizers on the Federal Budget* (April 2011).

9. The AMT is intended to curtail the extent to which higher-income people can reduce their tax liability through the use of preferences in the tax code. CBO anticipates that the impact of higher taxes under the AMT will largely be delayed until 2013, when most of those additional taxes will be paid if no further legislation limiting the reach of the AMT is enacted.

achieved by enacting proposals from the committee. That spending reduction (with an allowance for interest savings subtracted) would be distributed evenly among those fiscal years.

CBO estimates that the fiscal restraint stemming from the expiration of provisions in the 2010 tax act and from enactment of the Budget Control Act—including $1.2 trillion in deficit reduction from legislation originating from the deficit reduction committee or from automatic spending cuts—will decrease real GDP in 2013 by between about 1½ percent and about 3½ percent compared with what it would have been otherwise.[10] However, CBO also estimates that the reduction in deficits resulting from those policies will boost output later in the decade.

Future fiscal policy is likely to differ from that embodied in current law in at least some respects, and those differences could have a significant impact on the economy. For example, the Congress might enact legislation from the deficit reduction committee that includes a different composition of policy changes or different timing for them than CBO has assumed in its baseline budget projections, or the Congress might alter fiscal policy in other ways. To illustrate how some widely anticipated changes to current law would affect the economy, CBO has examined an alternative path for fiscal policy that includes these assumptions: Most of the provisions of individual income taxes and estate and gift taxes now scheduled to expire in December 2012 are extended through 2021; limits to the reach of the AMT that are set to expire at the end of 2011 are also continued through 2021; and Medicare's payment rates for physicians are maintained at their 2011 levels. (Those possible changes to current law would be a continuation of current policies that have previously been extended; they do not represent a prediction or recommendation about future policies.) Under that set of policies, budget deficits would be significantly larger than those in CBO's baseline budget projections, and federal debt held by the public would accumulate much more rapidly.

Under those alternative assumptions, real GDP would be higher in the first few years of the projection period than it is in CBO's economic forecast. For example, CBO estimates that real GDP in 2013 would be between 0.6 percent and 2.3 percent greater than projected under current law. Faster GDP growth would result in a lower unemployment rate in 2013 by between 0.3 percentage points and 1.1 percentage points; it would also result in somewhat higher interest rates that year—the rate on

10. To reflect the high degree of uncertainty that accompanies estimates of the economic impact of fiscal policy, CBO used a range of assumptions about the extent to which changes in taxes and government spending affect the demand for goods and services, budget deficits affect private investment, and changes in marginal tax rates on labor income affect the labor supply. For more information about some of those assumptions, see Congressional Budget Office, *The Macroeconomic and Budgetary Effects of an Illustrative Policy for Reducing the Federal Budget Deficit* (July 2011); and for a discussion of estimation methods, see Congressional Budget Office, *An Analysis of the President's Budgetary Proposals for Fiscal Year 2012* (April 2011).

10-year Treasury notes would be 20 to 30 basis points higher.[11] In later years, however, real GDP would fall below the level in CBO's baseline projections by ever larger amounts over time. The lower marginal tax rates under those alternative assumptions would increase people's incentives to work and save, but the larger budget deficits would reduce ("crowd out") private investment in productive uses of capital. By the end of 2021, as the effect of larger budget deficits outweighed that of lower tax rates, real GDP would be between 0.3 percent and 1.9 percent smaller than it would be under current law, CBO estimates.[12] In years beyond 2021, the impact of the alternative assumptions in reducing real GDP relative to the amounts under current law would increase.

Uncertainty in the Economic Outlook

Economic forecasts are always subject to a considerable degree of uncertainty, but the current uncertainty surrounding the economic outlook is especially great because the present business cycle has been unusual in a variety of ways. CBO constructs its economic forecasts to be in the middle of the distribution of possible future outcomes for the economy under an assumption that current law remains unchanged. Many developments could cause economic outcomes to differ substantially, in one direction or the other, from those CBO has projected. Key areas of uncertainty in the economic outlook include the following factors:

- The degree to which households want to increase their savings and further reduce their debt burdens,
- The ways in which lenders adjust their standards and terms for borrowing,
- The pace at which firms hire and invest,
- The timing and magnitude of a recovery in the housing market,
- The evolution of people's and businesses' confidence about the path of the economy,
- Changes in stock prices and long-term interest rates,
- The resolution of concerns that some European governments may default on their debts, and
- The path of U.S. fiscal policy.

11. A basis point is one-hundredth of a percentage point.

12. The additional growth in federal debt under those alternative assumptions would also increase the risk of a fiscal crisis; see Congressional Budget Office, *Federal Debt and the Risk of a Fiscal Crisis*, Issue Brief (July 2010).

Different outcomes for those factors could combine to have quite divergent effects: from boosting the growth of the U.S. economy significantly to causing a new recession, or producing some result in between.

Selected Fiscal Policy Options for Increasing Economic Growth and Employment in 2012 and 2013

The weakness of the economic recovery to date and the high levels of unemployment projected by most forecasters for the next few years have spurred ongoing discussions among analysts and policymakers about what steps the federal government might take to boost growth and employment. Some possible actions involve changes in tax or spending policies; others involve changes in regulatory policies or other policies.

To aid the Congress in the assessment of policy alternatives, CBO has estimated the effects of a variety of changes in tax and spending policies on output and employment over the next two years. The policy options that CBO analyzed would affect the economy in three different ways:

- Primarily by boosting households' disposable income,
- Primarily by providing support to businesses, and
- By increasing aid to state governments or government spending on infrastructure.

CBO estimated that the policy options it considered would range in their potential effect on GDP in 2012 and 2013 from raising it by as little as 10 cents per dollar of budgetary cost to increasing it by as much as $1.90 per dollar of budgetary cost. The largest feasible magnitude of the total budgetary cost varies among the policies, but all of the options considered are sufficiently scalable such that they could involve at least $10 billion of spending increases or tax cuts in 2012 and 2013. Some fiscal policies that would have little effect on the budget in 2012 and 2013 could nonetheless significantly affect output and employment in those years. For example, large changes to tax or spending policies that were enacted today and were scheduled to take effect in 2014 could affect the behavior of households and firms right away. However, this analysis does not include any fiscal policy options of that sort.

Considerations in Designing Fiscal Policy

Some policymakers and analysts have advocated near-term reductions in taxes or increases in federal spending to boost output and employment in the next few years. At the same time, many are concerned about the prospect of a further rise in federal debt. There is no inherent contradiction, however, between using fiscal policy to support the economy today, while unemployment is high and many factories and offices

are underused, and imposing fiscal restraint some years from now, when output and employment will probably be close to their potential.[13]

Even without any additional policy action, market forces will ultimately bring output and employment back to their potential. Before that occurs, however, many workers will remain or will become unemployed, and much capacity of facilities and equipment will be unused. Those unemployed workers and unused capital resources represent a waste of the economy's ability to produce goods and services, and the production that is lost cannot be made up later. Increased private and public spending during this period would employ those resources and raise the economy's production. After the economy has returned to its potential, the constraint on output will be the economy's capacity to produce goods and services, which depends on the stock of productive capital, the quantity and quality of labor, and the efficiency with which those resources are combined. Over that longer term, the more that households, businesses, and governments save, the more that can be invested in productive capital, which is why economists tend to emphasize the long-term benefits of saving relative to spending.

The current challenge for policymakers is that the reductions in taxes and increases in federal spending that would boost demand for goods and services in the short term would also increase government debt, which in turn would reduce the capital stock in the long term. Moreover, if people believed that policy changes that increased near-term deficits presaged larger deficits in the future and thus that the federal budget outlook had become even bleaker, the economy could be hurt in the near term by a faltering of business and consumer confidence and an increase in interest rates. Therefore, if policymakers wanted to use fiscal policy to provide a short-term economic boost without hindering the economy later, a combination of policies would be required: changes in taxes and spending that would widen the deficit now but reduce it later in the decade.

In evaluating fiscal policy that is intended to boost demand in the short term, three important considerations are whether the policy change is *timely*—providing help when it is needed; *cost-effective*—generating a large amount of additional output and employment per dollar cost to the federal budget; and *consistent with long-run fiscal objectives*—not worsening the long-run budget outlook.[14] Other considerations include the distribution of benefits among different people, the social value of additional goods and services that would be produced, and uncertainty about a policy's effectiveness.

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13. See the Statement of Douglas W. Elmendorf, Director, Congressional Budget Office, before the Joint Select Committee on Deficit Reduction, *Confronting the Nation's Fiscal Policy Challenges* (September 13, 2011).

14. See the Statement of Douglas W. Elmendorf, *The State of the Economy and Issues in Developing an Effective Policy Response* (January 27, 2009).

Timing. Fiscal policies differ greatly in how quickly they would affect the demand for goods and services, and some measures might take effect too slowly in two respects. First, they might miss the period of greatest need in terms of both unemployment and unused capacity. Second, they might persist while the amount of unemployment and excess capacity dropped into a range where the risk of pushing up inflation could be more significant.

Current law implies significant fiscal restraint in 2012 and 2013. Because of that restraint and the other factors slowing the recovery, CBO projects that the unemployment rate will remain close to 9 percent through the end of 2012; at that level, it will be about 3 percentage points above the agency's estimate of the rate that could be reached without raising the rate of inflation.[15] Additional policy actions that had their greatest impact during the next few years would affect the economy when its output will probably be well below its potential, the risk of greater weakness remains elevated, and the risk of excessive inflation is low. If widely anticipated changes to current law, such as an extension of tax cuts that are scheduled to expire under current law, were enacted, economic growth would be notably stronger in 2013, according to CBO's projections. However, even under those alternative policies, the economy would still be considerably below potential over the next few years.

Certain decreases in taxes or increases in federal spending could be implemented fairly quickly, and households, businesses, and other levels of government might respond with changes in their own spending fairly quickly as well. However, other changes in taxes or government spending might affect the economy only with considerable lags. For example, larger increases in funding for government activities tend to be spent more slowly than smaller increases, and many public infrastructure projects—which require extensive planning and coordination among different levels of government—take some time to implement.

Cost-Effectiveness. Possible reductions in taxes or increases in federal spending differ in the extent to which they would boost spending by households, businesses, and governments per dollar of budgetary cost. Cost-effectiveness can be assessed by the cumulative dollar effect on output and employment per dollar of budgetary cost.

Households. Tax cuts and government transfers to individuals increase households' disposable income. The cost-effectiveness of such policies depends on the fraction of the additional income that is spent on purchasing goods and services. Measures targeting households facing financial problems, such as those that have low income or unemployed members, tend to have larger impacts on spending and thus are more cost-

15. CBO estimates that the rate of unemployment that could be reached without raising the rate of inflation, which is to say the rate of unemployment stemming from sources other than the business cycle, is currently about 6 percent. In the agency's estimation, that rate will decline over the coming decade, enabling the unemployment rate ultimately to fall below 6 percent without spurring inflation. For further discussion, see Congressional Budget Office, *The Budget and Economic Outlook: An Update* (August 2011), pp. 45–46.

effective. By contrast, measures that are less well targeted, such as across-the-board reductions in income tax rates or broad tax rebates, provide large parts of their relief to people who are less constrained financially. Such people are likely to save much of a tax reduction, especially if it is temporary. In that case, the policy would be less cost-effective in boosting output and employment in the short run.

Businesses. Some policies seek to encourage business spending by providing incentives for new investment, such as allowing firms to "expense" their investment costs for tax purposes—that is, to deduct the cost of an investment in the year it is made. Those policies increase firms' after-tax return on investment by reducing the present value of taxes, and they increase firms' cash flow for the year in which the new investment is made. The success of such incentives in encouraging spending probably depends on the economic conditions when the incentives are in effect: A reduction in the cost of capital is likely to have less effect on a business's decision to buy new machinery if demand for the business's output is so low that the machinery would get little use. Several studies suggest that the impact of being able to expense investment costs in the early 2000s, when demand was weak, was modest.[16]

Other fiscal policies encourage hiring by temporarily or permanently reducing the cost of labor. The cost-effectiveness of those policies depends on firms' responses to the benefits received: whether they pass the benefits on to customers in the form of lower prices, to employees in the form of higher wages, or implicitly to shareholders by retaining them as profits—and how much they increase hiring and hours worked during a period when labor is temporarily less expensive.

Government. The federal government can boost demand by increasing its own purchases of goods and services or by providing funds to state and local governments. Purchases by the federal government tend to be cost-effective in terms of the number of jobs generated per dollar of budgetary cost because they involve direct purchases from firms or the hiring of workers. Federal grants to state and local governments can increase total demand by inducing those governments to keep their taxes lower, or their transfer payments and purchases of goods and services higher, than they would otherwise. However, if greater federal aid simply leads state and local governments to borrow less, with no effect on their taxes or spending, then it does not increase demand in the short run.[17]

In the current economic environment, additional federal aid to state and local governments would probably reduce the size of tax increases and spending cuts enacted by those jurisdictions to balance their budgets. The amount of state and local budget cutting has been very large in recent years, despite the additional federal aid provided through ARRA and other legislation, and would probably have been even larger with-

16. For a summary of the literature on the effects of partial expensing in the early 2000s, see Congressional Budget Office, *Options for Responding to Short-Term Economic Weakness.*

17. See John B. Taylor, "An Empirical Analysis of the Revival of Fiscal Activism in the 2000s," *Journal of Economic Literature*, vol. 49, no. 3 (September 2011), pp. 686–702.

out such additional aid. For example, employment by state and local governments has fallen by nearly 650,000 since its peak in August 2008. Heading into fiscal year 2012 (which began in July for most states), 38 states faced projected budget shortfalls; of those, 21 states faced imbalances of 10 percent or more of their general fund spending. Although states made changes to their policies to eliminate those near-term gaps, a number of states are already projecting shortfalls for the next few years.[18]

Consistency with Long-Run Fiscal Objectives. In large part because of the weak economy and actions the government has taken in response, the budget deficit has been larger relative to GDP during the past three years than in any other years since 1945. As a result, debt held by the public at the end of fiscal year 2011 was 68 percent of GDP—the highest since 1950 and up from 40 percent at the end of 2008. Under current law, deficits are projected to drop markedly as a share of GDP over the next few years. However, current law provides for substantial changes to tax and spending policies in coming years. If those changes did not occur and current policies were continued instead, much larger deficits and much greater debt would result.[19]

If taxes were cut permanently or government spending was increased permanently, and no other changes were made to fiscal policy, the economy would suffer in the medium term and long term as the federal debt mounted. Indeed, if people believed that policy changes that increased near-term deficits would also widen budget deficits in subsequent years, the economy could be hurt in the near term by a weakening of business and consumer confidence and an increase in interest rates. Moreover, even if tax cuts or spending increases were temporary, the additional debt accumulated during that temporary period would weigh on the budget and the economy over time.

Therefore, if policymakers wanted to achieve both a short-term economic boost and longer-term fiscal sustainability, a combination of policies would be required: changes in taxes and spending that would widen the deficit now but reduce it later in the decade. Such an approach would work best if the future policy changes were sufficiently specific and widely supported so that households, businesses, state and local governments, and participants in financial markets believed that the future fiscal restraint would truly take effect.

Other Considerations. Other considerations also are relevant for decisions about fiscal policies to promote economic growth and employment in the near term—for example, who would be helped the most by the new policies. Different sorts of spending increases and tax reductions would provide direct benefits to different people and firms. Such distributional considerations are not analyzed in this testimony.

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18. See National Conference of State Legislatures, *State Budget Update: Summer 2011* (September 2011).

19. For further discussion, see Congressional Budget Office, *The Budget and Economic Outlook: An Update* (August 2011), pp. 23–29; and the Statement of Douglas W. Elmendorf, *Confronting the Nation's Fiscal Policy Challenges* (September 13, 2011).

Another consideration involves the types of additional goods and services that society would produce and from which it would realize benefits. Some analysts have argued that countercyclical fiscal policy should be evaluated on the basis of how well it recreates the composition of total spending that would be achieved in the absence of other constraints on policy.[20] Other observers have offered their own analyses and judgments about what sorts of additional goods and services would be most valuable for society. The key point is that fiscal policies can be judged not only on their contribution to growth and job creation in the near term but also on the extent to which they accomplish other goals.

A third consideration involves the combination of policies that might be chosen. Most economists agree that fiscal policies can boost demand during economic downturns and help smooth business cycles. However, some economists are skeptical about the efficacy of such policies and the magnitude of their effects. One benefit of a diversified portfolio of policies is that the overall effect on the economy would be less uncertain than with a single policy. Moreover, the benefits of such a portfolio of policies might spread more widely among different groups in the population and thus accomplish a larger variety of goals.

CBO's Analytical Approach

CBO assessed the potential of selected fiscal policy options for promoting economic growth and increasing employment.[21] The policy options would work somewhat differently depending on whether they sought to support spending by households, businesses, or governments:

- Policy options aimed at assisting households would spur demand for goods and services to varying degrees and thereby boost production to varying degrees. Because businesses' decisions on investing and hiring depend on the demand for their products, greater demand and production would lead to more investment and hiring. The size of those effects would depend largely on which households paid less in taxes or received more in benefits.

- Policy options that supported businesses would operate somewhat differently. Certain policies would reduce labor costs or the cost of investment, which would spur hiring and investment and in turn increase production and household income. The rise in income would support consumer demand and increase production by other firms.

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20. See N. Gregory Mankiw and Matthew Weinzierl, "An Exploration of Optimal Stabilization Policy," *Brookings Papers on Economic Activity* (Spring 2011), pp. 209–249.

21. Most of the fiscal policy options assessed in this testimony are similar to those assessed in Congressional Budget Office, *Policies for Increasing Economic Growth and Employment in 2010 and 2011* (January 2010).

- Additional government spending for goods and services would also boost output and employment, both directly (through the government-funded activity) and indirectly (through increases in consumer demand for goods and services resulting from the higher income of the households and firms that directly benefited from the government activity).

For this analysis, fiscal policy options were assumed to be temporary by design—that is, to be in effect for specific time periods or for specific dollar amounts. However, some options that would extend policies currently in place might be viewed as permanent by the beneficiaries. Alternatively, policies could also be designed to be permanent.

The analysis of each fiscal policy option presented in this testimony focuses on how it would affect output and employment. For each option, CBO used evidence from empirical studies and econometric models to estimate the impact on:

- Output—the cumulative effects on GDP per dollar of total budgetary cost (measured in terms of additional government spending or reduction in taxes), and

- Employment—the cumulative effects on years of full-time-equivalent employment (FTE-years) per million dollars of total budgetary cost.

Those effects were estimated for 2012 and for 2012 and 2013 together. The approach adopted to measure the effects of policies is similar to the method that CBO has used to assess the effects of ARRA.[22]

Estimated impacts on output include the direct and indirect effects of a dollar's worth of a given policy. Direct effects consist of immediate effects on economic activity. For example, government purchases of goods and services directly elicit economic activity and thereby have a direct dollar-for-dollar impact on output. Indirect effects may enhance or offset the direct effects. For example, if the economy has idle resources, as it does now, government funding for projects can lead to the hiring of otherwise unemployed workers. The additional spending by those workers, who now would have more income, would constitute a positive indirect effect. In contrast, a substantial increase in government spending financed by borrowing tends to drive up interest rates, which discourages spending on investment and on durable goods by raising the cost of borrowed funds. Those indirect crowding-out effects would offset some of the direct effects. Low and high estimates of the effects on output for a given policy were chosen, on a judgmental basis, to encompass most economists' views about the effects of that type of policy.

22. For a recent example of that approach, see Congressional Budget Office, *Estimated Impact of the American Recovery and Reinvestment Act on Employment and Economic Output from April 2011 Through June 2011*.

Fiscal policies may also affect spending by altering uncertainty or confidence about future economic conditions or government policies. For example, many firms appear to be uncertain today about future demand for their products, and that uncertainty seems to be leading them to be cautious about increasing their investment and hiring. Fiscal policy actions that boosted demand might help dissipate that uncertainty and increase employment.[23] However, some fiscal policy actions might exacerbate uncertainty about future government policies—for example, if firms' managers wondered whether a temporary policy might later be extended or what other changes in fiscal policy might be made later. Because quantifying reactions of this sort to changes in fiscal policy would be extremely difficult, the analysis in this testimony does not incorporate such reactions.

The monetary policy of the Federal Reserve has an important influence on the economic effects of changes in taxes and government spending. On the basis of the economic conditions that CBO projects and the stated intentions of the Federal Reserve, in this analysis CBO assumed that, through 2013, the Federal Reserve would not reduce the amount of support to economic activity it was providing through its own policies (such as decisions about setting the federal funds rate and using other tools) to offset any additional output and employment generated by fiscal policy. In contrast, under more normal economic conditions, CBO estimates, changes in interest rates would offset roughly two-thirds of the cumulative short-term impact on GDP of changes in fiscal policy.

To assess a policy's impact on employment, CBO used a series of steps to translate the estimated effects on output into estimated effects on FTE-years. First, CBO calculated the impact on the output gap—the percentage difference between actual output and potential output. Next, CBO calculated the magnitude and timing of effects of changes in the output gap on productivity, hours per worker, and the unemployment rate using the historical relationships between those measures. Changes in the output gap affect unemployment gradually over several quarters. Initially, part of a rise in output shows up as higher productivity and hours per worker rather than as reduced unemployment. CBO also took account of the effect on the size of the labor force of changes in employment, because discouraged workers and people who have chosen to pursue activities such as schooling rather than work tend to return to the labor force when unemployment declines and the economic environment improves.

Measuring the impact on employment per million dollars of budgetary cost in FTE-years (each being 40 hours of employment per week for one year) incorporated the effects of policies on hours worked in addition to their impact on the number of people who would be employed. Projected increases in the average number of people employed during a year do not include shifts from part-time to full-time work or overtime and are generally somewhat smaller than increases in FTE-years.

23. See Nicholas Bloom, "The Impact of Uncertainty Shocks," *Econometrica*, vol. 77, no. 3 (May 2009), pp. 623–685.

CBO's estimates imply that, for most policy options, one year of FTE employment is created for roughly every $110,000 in additional GDP. Therefore, if a policy increases cumulative GDP by one dollar per dollar of budgetary cost, one year of FTE employment is created for roughly $110,000 in budgetary cost. Policy options with smaller effects on GDP require more budgetary resources to generate a given amount of employment, and those with larger effects on GDP require less budgetary resources.[24]

In this analysis, CBO considered each policy in isolation. Certain combinations of policies could have larger effects per dollar of budgetary cost than those reported here. For example, undertaking a policy with a relatively large effect on output per dollar of budgetary cost and cutting back by an equal amount on an existing policy with a smaller effect on output per dollar of budgetary cost would increase output and employment in the short run at no net budgetary cost.

The effects on output and employment estimated in this analysis differ from those estimated in CBO's January 2010 analysis for several reasons:[25]

- First, as a result of its ongoing review of relevant research, CBO has reduced the lower end of its range of estimates of the short-term effects of changes in fiscal policy on output and employment, while leaving the upper end of the range unchanged.

- Second, for the earlier analysis, CBO assumed that policies beginning in 2010 would take effect in March of that year; for this analysis, CBO assumed that policies beginning in 2012 would take effect in January. The earlier implementation tends to increase the estimated economic effects in the first year.

- Third, at the time of the January 2010 analysis, CBO projected that the Federal Reserve would begin to tighten monetary policy by the fourth quarter of 2011 and therefore would be more likely to tighten further by that point in response to the changes in fiscal policy. Because of the ongoing weakness of the economy, CBO now projects that the Federal Reserve will not begin to tighten monetary policy until the first quarter of 2014. Because the Federal Reserve is assumed to not respond to fiscal policy changes for a longer period, the estimated economic effects of such policy changes are greater.[26]

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24. One might attempt to calculate the budgetary cost per FTE-year for different policies by inverting the number of cumulative years of full-time employment per million dollars of budgetary cost that is reported below. However, such calculations could be misleading for two reasons. First, for many of the options considered here, employment is affected beyond 2013 (in part because effects on employment lag behind those on GDP). Second, CBO's ranges of estimated effects on GDP (and thereby employment) are chosen to be centered relative to the distribution of possible outcomes, but the inverses of those ranges are not necessarily centered relative to the distribution of the inverses of those outcomes.

25. See Congressional Budget Office, *Policies for Increasing Economic Growth and Employment in 2010 and 2011* (January 2010).

26. In addition, the earlier publication reported cumulative effects on GDP over a five-year period rather than over the one- and two-year periods shown in this publication. In most cases, the shorter period in this analysis implies smaller cumulative estimated effects.

- Finally, specific changes were made in the analysis of certain options. Those changes are noted in the presentation of results for those options.

Fiscal Policy Options for Assisting Households

Policies that would temporarily increase the after-tax income of people who are relatively well off would probably have little effect on their spending because they are able to consume out of their current income or assets. However, policies that increased the resources of families with lower income, few assets, and poor credit would probably have a larger impact on their spending. Because of the extent of job losses and declines in asset prices in this economic downturn, more families probably have those attributes now than was the case in the immediate aftermath of many previous recessions. CBO analyzed the following fiscal policy options that would affect the economy primarily by assisting households:

- Increasing aid to the unemployed,
- Providing additional refundable tax credits to lower- and middle-income households in 2012,
- Reducing employees' payroll taxes,
- Subsidizing the interest rate on certain mortgages that are refinanced,
- Extending higher exemption amounts for the alternative minimum tax, and
- Reducing income taxes in 2013 relative to those specified in current law.

Increasing Aid to the Unemployed. Under current law, some people who exhaust their unemployment benefits are eligible to begin receiving additional weeks of benefits through emergency unemployment compensation (EUC) through January 3, 2012. (Benefits will begin to phase out after that date, with no EUC being paid after May 2012.) EUC currently provides up to 53 weeks of additional benefits (depending on the unemployment rate in one's state) after regular state benefits (which generally last up to 26 weeks) have been exhausted. The policy option analyzed by CBO would provide further assistance to the unemployed by extending the date by which individuals can start to receive EUC by a year—to January 3, 2013; under this option, no added benefits would be paid after May 2013.

Extending additional unemployment benefits would directly help those who would otherwise exhaust their unemployment benefits during calendar year 2012. Households receiving unemployment benefits tend to spend the additional benefits quickly, making this option both timely and cost-effective in spurring demand for goods and services, and thereby economic activity and employment.

In addition to increasing aggregate demand, extending additional unemployment benefits would also influence the labor market in other ways. Extending those benefits

would encourage some people to continue to seek employment in order to collect benefits rather than dropping out of the labor force, but it would also reduce the intensity of some workers' efforts to search for a new job because the higher benefits would lessen the hardship of being unemployed. Both of those effects of the benefit extensions would tend to increase the unemployment rate. However, many jobs that were not sought by workers receiving unemployment insurance would go instead to individuals who were not eligible for such benefits (such as new entrants to the labor force) and might otherwise be unemployed themselves, so the net impact on the unemployment rate from some workers' reduced efforts to find a job would be slight. In addition, other effects of extending unemployment benefits would boost employment. For example, some of the unemployed who would otherwise have dropped out of the labor force and instead continue job hunting in order to collect benefits would find jobs. In addition, because unemployment insurance can facilitate mobility to new occupations by providing a safety net if job transitions do not work out, it may also lead to better matches between workers and jobs.

In CBO's assessment, the various effects of extending additional unemployment benefits *apart from* the effects on the overall demand for goods and services would, on balance, increase the measured unemployment rate (primarily by keeping workers in the labor force) but have little effect on the number of people employed. Accordingly, CBO's estimates of the impact of this policy option on output and employment include only the effects of boosting demand for goods and services.

CBO estimates that this policy option would raise output cumulatively in 2012 and 2013 by $0.40 to $1.90 per dollar of total budgetary cost (see Table 1). CBO also estimates that the policies would add 4 to 19 cumulative years of FTE employment in 2012 and 2013 per million dollars of total budgetary cost.

Providing Additional Refundable Tax Credits for Lower- and Middle-Income Households in 2012. Some tax credits are refundable—that is, the government makes cash payments to people for whom the credit exceeds their income tax liability. The Economic Stimulus Act of 2008 included a particular type of refundable tax credit, one that was prepaid via checks mailed to households. ARRA also contained several provisions regarding refundable tax credits, including the Making Work Pay credit. CBO analyzed a policy similar to the credit in the Economic Stimulus Act that would result in payments to households during the last three quarters of 2012.[27]

27. This policy differs from the similar policy that CBO analyzed in January 2010 primarily as to when households would receive the payments. Under the policy discussed here, most of the credits would be received in the second quarter of 2012. Under the policy analyzed previously, the credits would have been paid evenly throughout 2011—a year after the policy was implemented and during a period when the Federal Reserve was projected to begin to offset some of the economic effects of the policy. Primarily for that reason, the estimated effects on output and employment of the policy analyzed here are larger than those shown in CBO's January 2010 report.

Table 1.

Estimated Effects of Fiscal Policy Options on Output and Employment

	Cumulative Effects on GDP[a] (Dollars per dollar of total budgetary cost)		Cumulative Effects on Employment[b] (Years of FTE employment per million dollars of total budgetary cost)	
	2012	2012–2013	2012	2012–2013
		Household Assistance		
Increasing Aid to the Unemployed	0.4 to 1.5	0.4 to 1.9	3 to 11	4 to 19
Providing Additional Refundable Tax Credits to Lower- and Middle-Income Households in 2012	0.2 to 1.0	0.2 to 1.2	2 to 8	2 to 12
Reducing Employees' Payroll Taxes	0.1 to 0.6	0.1 to 0.9	1 to 5	1 to 9
Subsidizing the Interest Rate on Certain Mortgages That Are Refinanced	0.1 to 0.5	0.2 to 1.1	1 to 3	2 to 10
Extending Higher Exemption Amounts for the Alternative Minimum Tax	*	0.2 to 1.1	**	2 to 9
Reducing Income Taxes in 2013 Relative to Those Specified in Current Law[c]	*	0.1 to 0.6	**	1 to 6
		Business Support		
Reducing Employers' Payroll Taxes	0.2 to 0.8	0.2 to 1.3	2 to 6	3 to 13
Reducing Employers' Payroll Taxes for Firms That Increase Their Payroll	0.2 to 0.8	0.2 to 1.3	3 to 8	4 to 16
Extending Full Expensing of Investment Costs[d]	0.1 to 0.7	0.1 to 1.1	1 to 5	1 to 11
Reducing Taxes on Business Income	* to 0.2	* to 0.3	** to 1	** to 3
Reducing Tax Rates on Repatriated Foreign Earnings[d]	* to 0.1	* to 0.2	** to 1	** to 1
		Aid to State Governments or Spending on Infrastructure		
Increasing Aid to States for Purposes Other Than Infrastructure	0.1 to 0.5	0.2 to 1.0	1 to 4	2 to 9
Increasing Spending on Infrastructure	0.1 to 0.2	0.1 to 0.7	0 to 1	1 to 6

Source: Congressional Budget Office.

Notes: The ranges of estimates were chosen, on a judgmental basis, encompass most economists' views.

Total budgetary cost is the amount of tax revenues or outlays over the full duration of a policy's effects, except as specified in note d below.

All years are calendar years. Unless otherwise specified, increased spending authority is assumed to be available as of January 2012, and tax options are assumed to be in effect only for 2012.

GDP = gross domestic product; FTE = full-time-equivalent; * = between zero and 0.05; ** = between zero and 0.5.

a. Estimated as GDP with a given policy minus GDP without the policy.

b. Estimated as years of FTE employment (FTE-years) with a given policy minus FTE-years without the policy. (An FTE-year is 40 hours of employment per week for one year.)

c. Includes the effects of extending higher exemption amounts for the alternative minimum tax in 2012.

d. For this option, total budgetary cost is calculated as a discounted present value rather than as the sum of changes in tax revenues over the full duration of the policy's effects.

Refundable credits are often phased out when income is above some amount and thus are effectively limited to lower- and middle- income households. Moreover, credits that are refundable provide a larger income boost to those households than do comparable credits that are not refundable, because lower-income households are more likely not to owe income tax. Therefore, providing additional refundable credits would increase after-tax income for households that are more likely than average to be restricted in their consumption by their current income and hence would spend a greater share of the funds received. As a result, providing such credits would increase output and employment by more per dollar of budgetary cost than would cutting taxes for a broader set of taxpayers whose consumption is less likely to be restrained by their current income.

CBO estimates that providing additional refundable tax credits would raise output cumulatively in 2012 and 2013 by $0.20 to $1.20 per dollar of total budgetary cost. CBO also estimates that the policy would add 2 to 12 cumulative years of FTE employment in 2012 and 2013 per million dollars of total budgetary cost.

Reducing Employees' Payroll Taxes. Social Security, which consists of Old-Age, Survivors, and Disability Insurance (OASDI), is financed by payroll taxes. Under current law, in 2012 and subsequent years, both employers and employees will pay 6.2 percent of the employees' annual earnings in Social Security payroll taxes up to a ceiling ($110,100 in 2012). For 2011, that rate was temporarily reduced to 4.2 percent for employees. This option would extend that tax reduction through the end of 2012.

A temporary reduction in employees' portion of the payroll tax would not immediately affect employers' costs. Instead, it would increase workers' disposable income. The increase in take-home pay would spur additional spending by the households receiving the higher income, and that higher spending would, in turn, increase production and employment. Those effects would be spread over time, however, and CBO expects that the majority of the temporary increase in take-home pay would be saved rather than spent.

CBO estimates that reducing employees' payroll taxes would raise output cumulatively in 2012 and 2013 by $0.10 to $0.90 per dollar of total budgetary cost. CBO also estimates that the policy would add one to nine cumulative years of FTE employment in 2012 and 2013 per million dollars of total budgetary cost.

Subsidizing the Interest Rate on Certain Mortgages That Are Refinanced. Numerous policy changes have been proposed to provide additional government support to the mortgage and housing markets and thereby boost overall output and employment. Some of those policy changes could be implemented by the Federal Reserve, Fannie Mae, Freddie Mac, or federal agencies under current law, while other proposed changes could require legislative action.

One area of concern among analysts is that, although mortgage rates have fallen to historically low levels, the volume of mortgage refinancing remains low for a number

of reasons. One is that many homeowners owe more on their existing mortgages than their homes are worth, so a refinanced mortgage with the same principal balance would not meet the loan-to-value standard required by Fannie Mae and Freddie Mac for guaranteeing new mortgages. Another is that lenders are reluctant to refinance mortgages because of the liabilities associated with closing new loans (generally called representations and warranties), limits on their ability to process large numbers of applications in a cost-effective manner, and difficulties arising from borrowers' second liens and mortgage insurance.

There have been a number of proposals for federal programs to provide refinancing opportunities to more mortgage borrowers. In 2009, the Administration created the Home Affordable Refinance Program (HARP) with that objective, and in October 2011, it announced an expansion of the program.[28] HARP allows borrowers with an existing mortgage guaranteed by Fannie Mae or Freddie Mac to refinance their mortgage with a streamlined underwriting process and relaxed eligibility criteria compared with standard mortgage refinancing terms. Policymakers could increase the impact of HARP by subsidizing the mortgage interest rate that participants pay. Such a subsidy would boost participation in the program and lower monthly mortgage payments for all borrowers who participate. CBO analyzed a policy that would provide a 0.25 percentage-point interest rate subsidy for the refinancing of loans during 2012 under the terms that are expected to apply under the newly expanded HARP.

That policy would lead more people to refinance their mortgages at lower interest rates. Those households would benefit from lower monthly mortgage payments, freeing up additional income for other purchases. The lenders and investors who hold those mortgages (directly or through mortgage-backed securities) would see those assets drop in value and would decrease their spending in response. However, that reduction in spending would be less than the increase in spending by borrowers for three reasons: Some of the holders of mortgages are institutions that are part of, or under the control of, the federal government (such as the Treasury Department, the Federal Reserve, Fannie Mae, and Freddie Mac); some of the holders are foreign citizens or institutions; and the private-sector holders in the United States generally would reduce their current spending by only a small share of the loss in their wealth. In addition, the reduction in mortgage payments for people who refinance would reduce the probability of their defaulting on their payments in the future, which would benefit both borrowers and lenders.[29]

The budgetary cost of this policy would include the subsidy itself as well as the effects of the decline in the value of mortgage-backed securities held by the Treasury, the

28. See Federal Housing Finance Agency, "FHFA, Fannie Mae, and Freddie Mac Announce HARP Changes to Reach More Borrowers" (press release, Washington, D.C., October 24, 2011).

29. For a discussion of the costs and benefits of a stylized refinancing program, see Mitchell Remy, Deborah Lucas, and Damien Moore, *An Evaluation of Large-Scale Mortgage Refinancing Programs*, Congressional Budget Office Working Paper 2011-4 (September 2011).

Federal Reserve, and government-sponsored enterprises such as Fannie Mae.[30] However, that cost would be partly offset by the resulting decrease in the number of loan defaults, which would reduce the cost to the government of making good on loan guarantees. CBO estimates that this policy would affect about 250 mortgages per million dollars of budgetary cost.

CBO estimates that adding this interest rate subsidy to HARP would raise output cumulatively in 2012 and 2013 by $0.20 to $1.10 per dollar of total budgetary cost.[31] CBO also estimates that the policy would add 2 to 10 cumulative years of FTE employment in 2012 and 2013 per million dollars of total budgetary cost.

Extending Higher Exemption Amounts for the Alternative Minimum Tax. The AMT was originally intended to impose taxes on high-income individuals who used tax preferences to greatly reduce or eliminate their liability under the regular income tax. For most of its existence, the AMT has played a minor role in the tax system, accounting for less than 2 percent of revenues from the individual income tax and affecting fewer than 1 percent of taxpayers in any year before 2000. However, unlike the regular income tax, the AMT is not indexed for inflation. As a result, the AMT will affect significantly larger numbers of taxpayers over time under current law, and lawmakers have acted repeatedly since 2001 to slow the expansion of the AMT and prevent it from affecting more taxpayers outside of higher-income groups. At the expiration of each of those "patches," the exemptions have been scheduled to revert to their prior-law levels, so the prospective year-to-year change in tax revenues from maintaining current law regarding the AMT has become larger each year. The current AMT patch expires at the end of December 2011. Hence, in 2012, under current law, the AMT will affect about 18 percent of taxpayers (up from less than 3 percent in 2009), who will pay, on average, $3,900 more in taxes than they would under the regular income tax system; nearly every married taxpayer filing jointly with income between $100,000 and $500,000 will owe some alternative tax. The option considered here would reduce taxes by extending the AMT patch for one year, through the end of 2012.

Although this policy would extend the AMT patch for only one year, CBO has concluded that most affected households would probably regard an extension of the AMT patch (relative to the current-law expiration of the existing patch) as permanent because it has routinely been extended in the past. Therefore, an extension of the

30. Portions of that projected budgetary cost were calculated on a present-value basis.

31. The losses that would be incurred by the Treasury, Fannie Mae, and Freddie Mac stemming from additional refinancing were estimated on a present-value basis, while the losses that would be incurred by the Federal Reserve were estimated on a cash basis. That approach is consistent with how the financial transactions of those entities are reflected in CBO's budget projections.

patch would be viewed by many households as having a lasting impact on their disposable income and would have a correspondingly greater impact on consumption than would a change that was viewed as temporary.[32]

Still, the impact of this option on consumption would probably be smaller than that of a tax cut that applied more broadly because the AMT largely affects people in the upper part of the income distribution, who, in comparison with others, would spend less of the income retained. In addition, although an extension of an AMT patch would affect people's tax liability in 2012, most of its impact on consumption would probably occur in 2013. The effect would be delayed both because many taxpayers are allowed to pay their 2012 AMT liability in 2013 and because the increase in liability in 2012 under current law would probably not be recognized immediately. In particular, taxpayers who have not previously paid the AMT may not know that they are becoming liable, and those previously liable for the AMT probably expect that another extension will be enacted; for both of those groups, the increased AMT liability under current law would not affect their consumption much until 2013, so changing the law would also not have much effect on their consumption until 2013.

CBO estimates that a one-year AMT patch would raise output cumulatively in 2012 and 2013 by $0.20 to $1.10 per dollar of total budgetary cost. CBO also estimates that the policy would add two to nine years of cumulative FTE employment in 2012 and 2013 per million dollars of total budgetary cost.

Reducing Income Taxes in 2013 Relative to Those Specified in Current Law. Various provisions originally enacted in the Economic Growth and Tax Relief Reconciliation Act of 2001 and the Jobs and Growth Tax Relief Reconciliation Act of 2003, and then extended by the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 (the 2010 tax act), will expire at the end of 2012, raising tax liabilities for most people. Policymakers could defer those increases as well as extend the higher exemption amounts for the AMT. Accordingly, CBO analyzed a policy that would extend for one year (through 2013) the tax reductions in the 2010 tax act related to EGTRRA and JGTRRA and would increase the exemption amounts for the AMT in both 2012 and 2013.

CBO has concluded that most households view the provisions of EGTRRA and JGTRRA as permanent. Therefore, in this analysis, CBO projects that households would respond to the extension of the EGTRRA and JGTRRA provisions as though those changes would have a lasting effect on their disposable income (just as they

32. This approach differs from the one that CBO used in its January 2010 analysis of fiscal policy options, which incorporated an assumption that households would respond to an extension of the AMT patch as having a temporary effect on their income. The current approach yields a greater effect on output and employment.

would view an extension of the AMT patch).[33] As compared with the effect of a one-year AMT patch, a greater share of the tax reduction from this option would benefit households who are farther down the income scale and therefore would probably spend a larger fraction of an increase in after-tax income. Still, only a small fraction of the tax cut in this option would be received by those whose consumption is restricted by their current disposable income.

Deferring the scheduled increases in tax rates in 2013 would help some businesses as well as households. In particular, it would keep lower tax rates in place in that year for businesses that do not pay the corporate income tax (that is, businesses such as sole proprietorships, partnerships, S corporations, and limited liability companies). However, increasing the after-tax income of businesses typically does not create much incentive for them to hire more workers in order to produce more, because production depends principally on their ability to sell their products.

CBO estimates that a two-year AMT patch and one-year deferral of the tax increases that are scheduled to result from expiration of the 2010 tax act provisions related to EGTRRA and JGTRRA would raise output in 2012 and 2013 by $0.10 to $0.60 per dollar of total budgetary cost. CBO also estimates that the policy would add one to six years of cumulative FTE employment in 2012 and 2013 per million dollars of total budgetary cost.

The effects of this policy per dollar of budgetary cost in 2012 and 2013 are smaller than the effects of just extending the AMT patch primarily because a greater portion of the effects of the AMT on revenues would occur earlier in 2013; thus, more of the effects on output and employment from extending the AMT patch would occur by the end of 2013. Much of the economic impact of this policy, by contrast, would not be felt until 2014.

One variant on this option would be to defer for one year most of the tax increases associated with the expiration of the 2010 tax act but allow the rate increases for the top brackets to go into effect. That option would be more cost-effective in boosting output and employment in the short run because the higher-income households that would probably spend a smaller fraction of any increase in their after-tax income would receive a smaller share of the reduction in taxes (relative to current law). However, the difference relative to the option analyzed here would be small, because excluding the top brackets from the tax cut would still not lead to a large portion of the tax reduction going to the low-income households who would be likely to spend a large share of additional income.

33. This approach differs from that used in CBO's January 2010 analysis of fiscal policy options, which projected that households would respond to an extension of the tax cuts as though those changes would have only a temporary effect on their income. The current approach implies a greater effect on output and employment.

Fiscal Policy Options Providing Support to Businesses

CBO analyzed the following fiscal policy options that would affect the economy primarily by providing support to businesses:

- Reducing employers' payroll taxes,
- Reducing employers' payroll taxes for firms that increase their payroll,
- Extending full expensing of investment costs,
- Reducing taxes on business income, and
- Reducing tax rates on repatriated foreign earnings.

Reducing Employers' Payroll Taxes. Under current law, in 2012 and subsequent years, both employers and employees will pay 6.2 percent of the employees' annual earnings in Social Security payroll taxes up to a ceiling ($110,100 in 2012).[34] CBO analyzed an option that would reduce employers' payroll taxes for 2012, while leaving employees' tax rate at 6.2 percent.

Firms would probably respond to this temporary reduction in their portion of the payroll tax through a combination of four channels. First, some firms would respond to lower employment costs by reducing the prices they charge in order to sell more goods or services. Those higher sales would in turn spur production, which would then increase hours worked and hiring.

Second, some firms would pass the tax savings on to employees in the form of higher wages or other forms of compensation, which in turn would encourage more spending by those employees. However, wages tend to be inflexible in the short run because of negotiation and administrative costs, so that response is not likely to be very large.

Third, some firms would retain the tax savings as profits. Higher profits would raise companies' stock prices, and the resulting higher household wealth would encourage more consumption, although shareholders would probably spend only a small portion of their gains. Higher profits would also improve cash flow, enabling firms facing borrowing constraints to buy new equipment.

Fourth, some firms would use slightly more labor during a period when it was temporarily less expensive. Some firms would use additional labor to enhance the quality of products and services in ways not reflected in GDP. Some would use additional labor to increase maintenance of existing equipment (such as preventive maintenance for motor vehicles), which would make equipment last longer and delay the need to invest in replacements. Depending on the type of products they made, some firms

34. For 2011, the 2010 tax act reduced the payroll tax paid by employees from 6.2 percent to 4.2 percent.

would also increase their use of labor that was temporarily less expensive while the policy was in effect and reduce their use of labor later. And some firms would hire a little sooner to cover anticipated increases in their labor needs. Under this option, however, most of the money forgone by the government would go to reduce taxes that firms pay for existing workers, so—per dollar of forgone revenues—the added incentive from lower labor costs to increase employment and hours worked would be small.

CBO estimates that reducing employers' payroll taxes would raise output cumulatively in 2012 and 2013 by $0.20 to $1.30 per dollar of total budgetary cost (see Table 1 on page 28). CBO also estimates that the policy would add 3 to 13 cumulative years of FTE employment in 2012 and 2013 per million dollars of total budgetary cost.

In comparison with the effects of reducing employees' payroll taxes, the effects of reducing employers' payroll taxes would be somewhat larger per dollar of forgone revenues. Reducing employers' payroll taxes for one year has an economic effect related to that of a temporary cut in sales taxes because a temporary reduction in prices (the first channel described above) would encourage purchases while the reduction was in effect. The effects on output and employment through that channel are estimated to be somewhat larger than the corresponding effects of increases in take-home pay from reducing employees' payroll taxes.

Reducing Employers' Payroll Taxes for Firms That Increase Their Payroll. The Hiring Incentives to Restore Employment Act of 2010 (HIRE, P.L. 111-147) reduced employers' payroll tax liabilities, but eligibility was limited to firms that hired people who had recently been unemployed.[35] CBO analyzed a related policy that would give employers a one-year nonrefundable credit against their payroll tax liability for incremental increases in their payroll—resulting either from hiring new workers or from increasing the hours worked by the firm's current workforce—during 2012.

Because the credit would be nonrefundable, the credit amount would not exceed the firm's payroll tax liability. Such a credit would be based on the payroll in each calendar quarter so that firms could receive the credit quickly. To prevent firms from firing existing employees and hiring new ones in order to obtain the credit, the amount of the credit would be based on the difference between the wage base in the current quarter and the wage base four quarters earlier. In addition, the eligible wage base would be capped at an annual amount for each employee. Wage bases can be calculated quarterly for most employers from information already reported to the Internal Revenue Service (under the Federal Insurance Contributions Act and the Federal Unemployment Tax Act), thus reducing the administrative costs of this option.

35. HIRE included two provisions targeted toward unemployed workers. Employers were exempted from paying their share of OASDI taxes (6.2 percent) from March 19, 2010, through December 31, 2010, for every person whom they hired who had been employed for 40 hours or less during the preceding 60 days, and were also eligible for a $1,000 retention credit for each of those workers retained for at least one year.

Providing tax credits for increases in payrolls would increase both output and employment. The effect on output would come through the same four channels as the effect on output of reducing employers' payroll taxes. CBO estimates that this option and the preceding one would have approximately the same economic impact per dollar of budgetary cost through the first three channels discussed above. Through the fourth channel, however, this option would provide a substantially larger increase in employment and hours worked than the previous option because this policy would provide tax benefits linked to payroll *growth*; fewer budget dollars would be used to cut taxes for workers who would have been employed anyway, so the incentive to increase payroll per dollar of forgone revenues would be greater. However, linking the availability of the credit to payroll growth would provide no incentive to maintain employment at firms that have been shrinking and thus less incentive to maintain employment overall in industries and regions where the economy remains the weakest.[36]

CBO estimates that reducing payroll taxes for firms that increase their payroll would raise output cumulatively in 2012 and 2013 by $0.20 to $1.30 per dollar of total budgetary cost. CBO also estimates that the policy would add 4 to 16 cumulative years of FTE employment in 2012 and 2013 per million dollars of total budgetary cost.

This policy would generate greater effects on employment per dollar of GDP than the other policies in support of businesses that are analyzed here because it would provide direct incentives for employers to increase employment in addition to its indirect effects on employment through its effects on output.

The choice of what cap (if any) to impose on the eligible wage base would affect the types of employment the policy fostered. A low cap would especially encourage the hiring of low-wage and part-time workers. For example, if the credit was calculated using the Federal Unemployment Tax Act wage base (which includes earnings only up to $7,000 annually for each employee), firms might have an incentive to hire, say, three part-time employees with annual wages of $20,000 each instead of one full-time employee with an annual wage of $60,000, because the former would increase payroll by $21,000 for the purpose of the credit, compared with an increase of only $7,000 for the latter.

Another design choice is whether the tax credit would be broad based or would apply only to a subset of firms. For example, if the main objective was to assist small businesses in hiring, the credit could be made available just for firms with a total number of employees, or total revenues, below some specified threshold. However, because small firms have more volatile employment dynamics (exhibiting high rates of creating and losing jobs and of entering and leaving the market), the average duration and the economic benefits of each subsidized job would probably be less than those under

36. Since its January 2010 analysis of fiscal policy options, CBO has updated its estimate of a key parameter for this option—the ratio of payroll increases to total payroll at firms that increase their payroll—to incorporate new data about payroll growth and improved projections of that growth. The current approach implies a slightly smaller effect on output and employment.

a broad-based program. In addition, because of that volatility, a greater fraction of the tax credits would be paid in response to payroll growth that would have occurred even without the policy.

The effects of this type of tax credit would also depend on other design choices.[37] To reduce efforts by firms to maximize their credit in ways inconsistent with the intent of the policy, growth that occurred through acquiring an existing business might be deemed not to count as a net increase in employment; however, such restrictions would make the policy more difficult to administer. If the credit was applied against businesses' income tax liability instead of their payroll tax liability and was nonrefundable, the policy would have a smaller effect: Employers that did not owe any income taxes—including firms with net operating losses, tax-exempt organizations, and state and local governments—would not be eligible for the credit. Firms with net operating losses could be allowed to apply the credit to tax liabilities in a subsequent year; still, among firms with net operating losses, the effect on hiring would be smaller because the credit would not be received immediately even if their payroll increased in 2012. Finally, the credit could be limited to certain categories of employees.

Extending Full Expensing of Investment Costs. The 2010 tax act allowed businesses to fully expense (deduct immediately from taxable income) the cost of their investment in qualifying property (mainly equipment) made in late 2010 and all of 2011; that provision expanded the partial expensing (sometimes called bonus depreciation) of 50 percent that was in effect from 2008 through most of 2010. The 2010 tax act also provided partial expensing of 50 percent for 2012. CBO analyzed a policy that would provide further incentives to invest by extending full expensing for one more year, through 2012.

Partial expensing or full expensing of investment costs allows firms to realize the tax benefits of depreciation deductions more quickly, which provides a greater incentive for investment because a dollar of tax benefit this year is more valuable than a dollar of tax benefit in a future year. Initial reductions in revenues are nearly fully offset by later increases. Therefore, CBO estimated the policy's effects per dollar of the present value of the revenue effects of the policy (discounted at businesses' cost of debt and equity) instead of per dollar of total budgetary cost.

The effect of the incentive is probably smaller when the economy is weak than when it is strong: Firms are less likely to increase investment when they have idle capacity and when they are less confident about the future demand for their products and services. In addition, when the economy slows, more firms incur losses and pay no income tax; some of those firms therefore get less benefit from immediate tax deductions, although firms that paid taxes in previous years may be able to reclaim some of those taxes. To the extent that temporarily reducing the after-tax price of investment

37. For further discussion, see Congressional Budget Office, letter to the Honorable Robert P. Casey Jr. providing CBO's assessment of a policy option to reduce payroll taxes for firms that increase their payroll (February 3, 2010).

accelerates the purchase of capital goods into the period when the tax incentive is available, that increased investment may be partially offset by a subsequent decrease when the incentive expires. In addition, the policy would probably have the greatest effect on investment just before it expired at the end of 2012 (as firms accelerated equipment purchases from 2013), so much of the indirect effect on output and employment would spill over into 2013.

CBO estimates that allowing full or partial expensing of investment costs would raise output cumulatively in 2012 and 2013 by $0.10 to $1.10 per dollar of the present value of budgetary cost. CBO also estimates that the policy would add 1 to 11 cumulative years of FTE employment in 2012 and 2013 per million dollars of net budgetary cost.

Reducing Business Income Taxes. Businesses—whether organized as C corporations, S corporations, partnerships, or sole proprietorships—are liable for income taxes that apply to their net income.[38] Income tax rates for businesses vary by organizational form and amount of income; a simple way to effectively reduce all of those tax rates by the same proportion is to allow all types of businesses to deduct a percentage of their net income in calculating their tax liability. CBO analyzed a policy that would allow such a percentage deduction in 2012.

The impact of this policy on output and employment would come primarily through its effect on the income and wealth of business owners and stockholders, who generally have higher-than-average income and would therefore tend to spend a fairly small share of temporary additions to their income and wealth. The proposal would also reduce the cost of capital for businesses because a larger share of pretax returns would be available to compensate investors after taxes were paid; however, that reduction would be only temporary under this policy, so it would probably have little effect on investment. In addition, the proposal could reduce prices slightly, because it would reduce the cost of labor compensation that is taken in the form of business income. (For example, a portion of the business income of sole proprietors represents compensation for their labor.) However, that effect would probably be most pronounced in industries that are generally composed of partnerships and sole proprietorships, and it is likely to be quite small in the aggregate.

CBO estimates that a one-year reduction in taxes on business income would raise output cumulatively in 2012 and 2013 by something between a negligible amount and $0.30 per dollar of total budgetary cost. CBO also estimates that the policy

38. Taxable income from C corporations is subject to the corporate income tax, and that income can be taxed again at the individual level after it is distributed to shareholders or investors. Income from S corporations generally is treated as personal income: It is subject only to the individual income tax, and it is taxed at the personal income tax rates of the businesses' owners. Businesses also can be established as partnerships or sole proprietorships. Their income is generally taxed at the individual income tax rates of their owners.

would add up to three cumulative years of FTE employment per million dollars of total budgetary cost.

A similar tax reduction targeted at small businesses would probably have effects on output and employment per dollar of total budgetary cost that were close to those for this option. As is the case with large businesses, a fairly small share of the income of small businesses goes to lower-income households that would spend a large fraction of their additional income.[39]

Reducing Tax Rates on Repatriated Foreign Earnings. American multinational corporations pay U.S. tax on income from their foreign operations when the income is repatriated to the U.S. parent company as dividends, minus a credit for foreign income taxes paid when the income was earned. CBO analyzed a policy that would reduce the tax rate on repatriated income in 2012 to 5.25 percent from the current corporate tax rate of 35 percent; such a policy would be a repeat of a temporary policy that was last implemented in 2004 by the American Jobs Creation Act.

A temporary reduction in the tax rate of that magnitude would probably result in a large amount of repatriated income next year—as much as $700 billion, according to an estimate by the staff of the Joint Committee on Taxation.[40] By taking advantage of the one-year tax break, companies would be able to reduce the total taxes they pay to bring money back to this country, although they would pay more in taxes during 2012. The government would collect more revenues next year but less in future years; the present discounted value of revenues would be reduced because of the tax break, creating a net cost to the government. As with the policy option allowing expensing for investment costs, this policy's effects are therefore estimated per dollar of the present value of the revenue effects of the policy (discounted at businesses' cost of debt and equity) instead of per dollar of total budgetary cost.

The short-term effect on U.S. output from such a policy would depend on the relative magnitude of several offsetting factors; CBO expects that the effect on output would probably be positive but much smaller than the net cost to the government. On the one hand, the reduction in tax liability would increase the value of the companies and thereby the wealth of their shareholders, which in turn would boost their spending to some extent. In addition, to the degree that firms are unable to finance profitable investments by borrowing or by using cash on hand, the reduction in the cost of accessing foreign earnings would increase U.S. investment. However, that effect is

39. For estimates of the proportion of small business income received by taxpayers having $50,000 or less of adjusted gross income, see Department of the Treasury, *Methodology to Identify Small Businesses and Their Owners*, Office of Tax Analysis Technical Paper 4 (August 2011), www.treasury.gov/resource-center/tax-policy/tax-analysis/Documents/OTA-T2011-04-Small-Business-Methodology-Aug-8-2011.pdf.

40. Letter from Thomas A. Barthold, Chief of Staff, Joint Committee on Taxation, U.S. Congress, to the Honorable Lloyd Doggett, April 15, 2011, *http://doggett.house.gov/images/pdf/jct_repatriation_score.pdf*.

probably small because many of the firms that would be affected have substantial cash holdings and ready access to capital markets. On the other hand, overseas earnings that are held in foreign currencies would have to be converted to U.S. dollars in order to be repatriated. That demand for dollars would raise the exchange value of the dollar, reducing U.S. net exports and domestic output.[41]

CBO estimates that a one-year reduction in taxes on repatriated income would raise output cumulatively in 2012 and 2013 by something between a negligible amount and $0.20 per dollar of the present value of budgetary cost. CBO also estimates that the policy would boost FTE employment by up to one cumulative year per million dollars of net budgetary cost.

Fiscal Policy Options Involving Aid to State Governments or Spending on Infrastructure

CBO analyzed the following fiscal policy options involving purchases by the federal government or aid to state governments:

- Increasing aid to states for purposes other than infrastructure and
- Increasing spending on infrastructure.

Increasing Aid to States for Purposes Other Than Infrastructure. Many states have experienced a high degree of fiscal stress as a result of the recession. Leading up to fiscal year 2012, 38 states faced projected budget shortfalls. They closed those gaps in a variety of ways, including reducing government employment, increasing revenues, and reducing transfer payments to households; nevertheless, many states are anticipating further large budget gaps in the next few years. Adding to budgetary pressures, spending financed by the aid to state governments provided by ARRA for purposes other than infrastructure, which totaled over $200 billion from 2009 through 2011, is projected to drop sharply in 2012. CBO analyzed a policy to assist states by providing funding to state governments for a variety of purposes. Even if funding was intended for a specific activity, such as education, CBO anticipates that

41. CBO estimates that the effects on investment and net exports would be small and roughly offsetting, so the effects of the policy on output and employment would be determined by the increase in spending by shareholders. A further effect not included in this analysis is that, after the tax rate returned to 35 percent, companies would tend to reduce the rate at which they repatriated foreign income to the extent they expected the temporary tax reduction to be repeated in the future.

the availability of additional funds would both increase net state spending for the specified activity and affect other aspects of state budgets.[42]

Without further aid from the federal government, many states would have to raise taxes or cut spending by more than they would if aid were provided. Such actions would dampen spending by those governments and by households in those states, and more state and private jobs would be lost. Under current law, many states will probably have to take such steps on an ongoing basis during the next few years, so federal aid that was provided promptly would probably have a significant effect on output and employment in 2012 and 2013. Such aid could lead to some combination of fewer layoffs of state and local government employees, more hiring of such employees, more pay raises or fewer pay cuts for those employees, more government purchases of goods and services, increases in state safety-net programs, and lower state and local taxes than would occur without the federal assistance. But some of the federal aid would probably be used to replenish or avoid drawing down states' reserve funds; aid used in that way would not boost the economy in the short term.

CBO estimates that providing aid to states for purposes other than infrastructure would raise output cumulatively in 2012 and 2013 by $0.20 to $1.00 per dollar of total budgetary cost (see Table 1 on page 28). CBO also estimates that the policy would add two to nine cumulative years of FTE employment in 2012 and 2013 per million dollars of total budgetary cost.

Increasing Spending on Infrastructure. ARRA provided about $60 billion for spending on water, transportation, and housing projects. CBO analyzed an option that would provide additional federal funding for infrastructure projects similar to those funded by ARRA.

Infrastructure spending directly increases employment because workers are hired to undertake construction projects. It also adds to demand for goods and services through purchases of material and equipment and through additional spending by the extra workers who are hired; as with other policy options discussed in this testimony, that increase in demand leads to further hiring. However, government spending on infrastructure projects could also cause private-sector spending to fall because of indirect crowding-out effects, as discussed earlier. In addition, CBO projects that states

42. In projecting how fast such federal aid would be disbursed, CBO relied heavily on the experience with grants to states provided under ARRA for purposes other than infrastructure or Medicaid. Most of those grants were related to education, with a small portion directed to other state and local spending programs; the timing of the disbursement of grants in those two categories was similar. Federal outlays for grants to states for Medicaid would be disbursed significantly faster, but the impact of those grants on state spending and revenue policies would lag behind the federal disbursements because it would take time for states to enact legislation to alter their policies in response.

would reduce spending of their own funds on infrastructure by about one-half of any increase in federal outlays for that purpose.[43]

One drawback of this option is that infrastructure projects often involve considerable start-up lags. Although some projects (such as highway repair and resurfacing) can be implemented relatively quickly, large-scale construction projects generally require years of planning and preparation. For example, building new transportation infrastructure that requires establishing new rights-of-way or developing and implementing alternative energy sources would probably have their biggest effects on output and employment after 2013. Indeed, trying to increase certain types of spending too quickly would raise the risk of making poor decisions about what specific projects should be supported. As a practical matter, the experience with ARRA suggests that the spending of infrastructure funds is slow: By the end of fiscal year 2009, seven and a half months after the legislation was enacted, less than 10 percent of the infrastructure funds provided by ARRA had been spent. Thus, most of the increases in output and employment from the option analyzed here would probably occur after 2012.[44]

CBO estimates that additional investments in infrastructure would raise output cumulatively in 2012 and 2013 by $0.10 to $0.70 per dollar of total budgetary cost. CBO also estimates that the policy would add one to six cumulative years of FTE employment in 2012 and 2013 per million dollars of total budgetary cost.

Longer-Run Effects

Over the long run, the nation's output depends on the size and composition of the capital stock, the quantity and quality of the labor force, and the nation's technological progress. Although the fiscal policy options analyzed here would increase output during the next few years, they would decrease output later because, by adding to federal budget deficits, they would reduce the amount of national saving and thus the size of the future capital stock. Because the policy options analyzed here are temporary, they would not generally have significant, lasting effects on the labor force or technology. However, to the degree that the policy options would reduce long-term

43. In its January 2010 analysis, CBO did not incorporate such an offset. That partial offset is consistent with evidence about states' behavior. The reduced state spending on infrastructure would, in turn, relieve pressure on state budgets in the same way as would additional federal aid to states for purposes other than infrastructure, allowing states to reduce revenues or increase other spending. Incorporating those effects on state policies slightly reduces the estimated effects of federal infrastructure spending on output and employment relative to CBO's earlier estimates because aid to states for other purposes is estimated to have smaller economic effects, on average, than infrastructure spending.

44. In addition to its effect on demand, well-chosen infrastructure spending can also increase the productivity of private activities (by reducing traffic congestion, for example). However, any such effect on total output would be small over the 2012–2013 period.

unemployment in the next few years, they might improve participation in the labor force, employment, and productivity in later years.[45]

The reduction in output over the longer run that would result from the smaller capital stock could be offset by other changes in fiscal policy or by other effects of the short-run policy options. First, if future increases in taxes or cuts in government spending enabled the government to pay off the additional accumulated debt, then output in the longer run would not necessarily be diminished by the crowding out of investment caused by the short-run policies. However, if the future increases in taxes or cuts in spending reduced the returns from investing and thereby discouraged some future private saving, output would still be lower on net in the long run. Second, policy options that would raise government or private investment—such as expensing of investment costs or infrastructure spending—can raise output in the short run with less (or even no) negative longer-run impact on output because they tend to increase the stock of productive capital directly. CBO has not attempted to estimate such effects.

How Fiscal Policy Options Would Affect the Nation's Capital Stock. The size of the capital stock owned by residents of the United States depends on national saving, which is the sum of personal saving, business saving (that is, after-tax corporate profits not paid as dividends), and saving or dissaving (as reflected in budget surpluses or deficits) by the federal government and state and local governments. Federal budget deficits reduce national saving, so all other things being equal, an increase in those deficits would decrease that saving—resulting in a smaller capital stock owned by U.S. residents over time. Reductions in household or business saving would have the same effect.

If the capital stock owned by U.S. residents was smaller, the amount of such capital invested overseas would also be smaller, and foreigners would tend to increase their investment in the United States (drawn by higher rates of return on the smaller stock of domestic capital), so the capital stock located in the United States would be diminished by less than the reduction in the capital stock owned by U.S. residents. Still, the smaller capital stock in the United States would lead to less output than would otherwise be possible because the labor force would have less capital to work with.

The impact of a fiscal policy option on the capital stock would depend partly on its effect on the federal budget deficit and partly on its effect on the saving of households, businesses, and state and local governments. In general, the more a policy option raised either government or private consumption in the short run—and thus the more it raised output in the short run—the more it would depress national saving. For example, cuts in taxes that boost consumption substantially would tend to decrease national saving (because the increase in government dissaving would not be offset very

45. See Ben S. Bernanke, "The Near- and Longer-Term Prospects for the U.S. Economy" (address given at the Federal Reserve Bank of Kansas City Economic Symposium, Jackson Hole, Wyoming, August 26, 2011).

much by an increase in private saving), and cuts in taxes that are largely saved would tend to decrease national saving only a little (because the increase in government dissaving would be offset to a significant extent by higher private saving).

An Illustrative Example. To provide a rough idea of the potential magnitude of the long-run economic effects of policies to boost output and employment in the next few years, CBO considered a simple illustrative example: an increase in government spending on goods and services (such as office supplies or government salaries) in 2012. Such spending would tend to have larger negative long-run effects on output than the fiscal policy options discussed earlier, for several reasons:

- Increasing government spending would boost purchases of goods and services on a dollar-for-dollar basis—in contrast with tax cuts, only some of which would translate into increased household spending. The larger impact of government purchases on spending implies more crowding out in the long run.
- All of the increase in the federal deficit would occur in the first year, producing a larger cumulative impact on the government's interest payments than would more gradual policies.
- Under an assumption that the increase in government spending would not increase the productivity of private capital, it would not provide any long-run boost to output.

In estimating the effects of such a policy beyond the next few years, CBO used an enhanced version of a widely used model developed by Robert Solow. To illustrate a range of possible effects, CBO assumed that each dollar increase in the deficit would reduce domestic investment by 20 or 50 cents (reflecting different assumptions about the effects of deficits on both national saving and net borrowing from abroad). Those alternative assumptions would cause the policy to have, respectively, smaller and larger effects on future output. On that basis, CBO estimates that a deficit-financed increase in government purchases in 2012 would reduce GDP by an amount between slightly above zero and $0.10 in 2021 per dollar of total budgetary cost (with amounts measured in 2012 dollars). The specific policy options discussed in this testimony would have a smaller negative effect on GDP in 2021, as they would lead to a smaller decline in the U.S. capital stock per dollar of budgetary cost.

Other Legislative Policy Options for Increasing Economic Growth and Employment in 2012 and 2013

Lawmakers can influence economic growth and employment during the next two years by changing policies that do not involve, or whose scope extends well beyond, taxation and government spending. For example, legislation could modify existing or proposed regulations, significantly alter the government's role in a particular sector of the economy, or change trade relationships with other countries. Other types of policy

changes that do not require legislation, such as those related to monetary policy or those that can be implemented by federal agencies under current law, could also affect economic activity, but they are outside the scope of this testimony.

Society's decisions to regulate or not regulate certain activities in certain ways generally involve balancing the advantages and disadvantages of the regulations being considered. For example, properly designed regulations can provide benefits by reducing damage to people's health or the environment, reducing the risks posed to the economy by the financial system, or advancing other social goals. But in achieving those benefits, regulations generally impose costs on businesses and their workers and customers through restrictions on choices or forgone output and employment. Those costs can be weighed against the benefits. Similarly, society's decisions to have the government play a particular role in a particular sector of the economy and to engage in international trade under specified rules generally involve balancing the advantages and disadvantages of various courses of action.

How Changes in Regulations and Other Types of Policies Apart from Fiscal Policies Can Affect the Economy

Changes in regulations—whether those regulations were imposed directly by legislation or promulgated by federal agencies in implementing laws—and in other types of policies apart from fiscal policies could affect output and employment during the next few years as well as over a longer time span. Those effects could occur through their impact on businesses' incentives to invest and hire, on the prices that people pay for goods and services, on businesses' and people's expectations about their future income, on uncertainty about future government policies and economic conditions, and on other factors that affect economic behavior.

Effects on Incentives to Invest and Hire and on Prices. The short-run economic impact of changing a policy other than a fiscal policy depends importantly on how that change affects businesses' investment decisions. To start, consider the effect of imposing or strengthening a regulation, or raising a barrier to international trade. Such a change in policy can reduce businesses' incentives to invest. For example, adding to the length or complexity of a process for reviewing firms' activities or granting permits for new projects would generally reduce investment by imposing extra costs to comply with the process (which would reduce the return on investments), by increasing the probability that a project will not be approved, and by delaying the return on investments in projects that proceed. In addition, changes in regulations that raise the cost of production for some firms may lead to increases in the prices of goods or services (such as energy) used as inputs by other firms, lowering the return on investments for those firms and therefore tending to reduce their investment. Moreover, strengthening trade barriers may negatively affect certain sectors of the economy and reduce the returns from investing in those sectors.

Yet, a change in policy of that sort can also increase investment in some ways. For example, requiring changes in production methods might necessitate investment in equipment or structures (such as pollution-control equipment) needed to comply

with the rules. (Incentives to invest in other types of capital in the affected industries could be reduced, however, because those higher costs might lower firms' return on those other investments.) Similarly, strengthening trade barriers that protect certain sectors of the economy could increase the returns from investing in those sectors.

Eliminating or weakening a regulation or lowering a barrier to international trade can reverse or avoid those various effects. The net impact of such a policy change on investment depends on the relative sizes of those effects, which differ across policies. To the extent that eliminating or weakening a regulation or lowering a trade barrier led to greater business investment in the short term, it would tend to boost output and employment during that span (even if its economic effects in the medium term and long term were quite different). Conversely, to the extent that the policy change led to less investment in the short term, it would tend to decrease output and employment during that span (again, even if its medium-term and long-term economic effects were different).

Changes in policies apart from fiscal policies can also affect businesses' hiring decisions. A policy change that encourages firms to invest more or that increases the demand for their products indirectly encourages those firms to increase the size of their workforces. In the other direction, a policy change that discourages firms from investing or decreases the demand for their products can lead firms to lay off workers or decrease the size of their workforces through attrition. Moreover, a policy change can directly enhance or diminish firms' incentives to hire workers for a given amount of capital or demand for their products.

In addition to their effect on businesses, changes in policies apart from fiscal policies can affect the prices that people have to pay for goods and services and hence the real value of their income. For example, policy changes that increase energy prices reduce households' purchasing power, whereas policy changes that lead to lower prices on goods and services raise households' purchasing power.

Changes in regulations and other policies apart from fiscal policies that directly affect investment or hiring by firms or directly affect consumer spending also have indirect effects, some of which tend to be positive, and some of which tend to be negative. Consider policy changes that would boost firms' investment or hiring or people's spending. On the one hand, additional spending resulting from such policies would generate profits and wages in other firms, some of which would be spent by the recipients, further increasing output. But any additional spending spurred by those policies could also crowd out other economic activity, making the net increase in activity small or nonexistent. The extent of such crowding out depends importantly on the overall level of economic activity. Under current economic conditions, CBO projects that such indirect effects, on net, probably strengthen policies' direct effects.

Effects on Expectations and Uncertainty. Changes to policies apart from fiscal policies can also affect output by changing people's expectations about their future income. For example, policies that improved businesses' expectations about the demand for their products and their income in the future would increase the value of the businesses and, therefore, the wealth of their owners; that effect would boost consumer

spending to a modest extent during the next few years and beyond.[46] Similarly, policies that improved people's expectations about their future income would lead to an increase in current spending by some households.[47]

Household spending can also be affected by people's expectations about the prices of goods and services, which can be influenced by changes in regulations and other policies. However, because the effect of most such policy changes on future prices would be small and uncertain, most people probably would respond only to a limited extent—particularly in the current economic environment.

Changes to regulations and other policies—or the prospect of them—can also affect the degree of uncertainty faced by businesses and households, which will in turn affect their spending. Some changes would decrease uncertainty about future government policies and economic conditions. For example, eliminating regulations that impose extensive review processes would reduce uncertainty about the prospects for investment projects. Similarly, reversing policies whose implementation will require the issuance of significant new regulations could diminish uncertainty about future prices of inputs, about the demand for certain products, and about the ways that some markets or sectors of the economy will operate in the future. However, some changes to regulations and other policies would heighten uncertainty. For example, eliminating regulations that are designed to meet a requirement of current law without repealing the law itself could increase uncertainty because businesses and people would not know what alternative approach to meeting that requirement might be implemented in the future. To the extent that policy changes reduce uncertainty, they would tend to increase businesses' investing and hiring and households' spending; to the extent that policy changes increase uncertainty, they would tend to have the opposite effects.

Potential Economic Effects of Changes in Particular Types of Policies Apart from Fiscal Policies

For this testimony, CBO considered changes in regulations and other policies in several areas:

- Energy and the environment,
- The financial sector,
- The health care sector, and
- International trade.

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46. The overall effect on consumer spending may not be positive if the increase in shareholders' wealth is offset by a direct cost to others that would decrease their spending—as would be the case, for example, for a decrease in the minimum wage.

47. See Jesús Fernández-Villaverde, Pablo Guerrón-Quintana, and Juan F. Rubio-Ramírez, *Supply-Side Policies and the Zero Lower Bound*, Working Paper No. 11-47 (Philadelphia, Pa.: Research Department, Federal Reserve Bank of Philadelphia, October 2011), www.philadelphiafed.org/research-and-data/publications/working-papers/2011/wp11-47.pdf.

Estimating the near-term effects on overall economic activity of most regulations or other policies apart from fiscal policies is exceedingly difficult, and few analytic tools are available for that purpose. Accordingly, the agency did not attempt to quantify the effects of specific changes in policies of this sort with any precision. Instead, CBO focused on whether selected changes in policies besides fiscal policies would probably increase or decrease output and employment during the next few years.

Importantly, in focusing on the near-term aggregate economic effects of policy changes, this discussion does not speak to other considerations that are critical in assessing such policies. Those considerations include the long-term effects on the economy, on people's health, and on the environment, as well as the many other priorities at the core of the policies.

Some changes in policies that CBO considered would probably raise output and employment during the next few years; other changes would probably lower output and employment; and some changes would have effects on economic activity whose sign is difficult to determine. However, in CBO's judgment, the economic effects of the specific policy changes discussed below probably would be too small or would occur too slowly to significantly alter overall output or employment in the next two years. The policy changes examined here are meant to be illustrative rather than exhaustive; many other possible policy changes, which might have larger or smaller economic effects, could be considered.

Energy and the Environment. Projects to increase the production of energy are typically subject to review by multiple levels of government. Federal agencies generally focus on compliance with national performance standards and on infrastructure that crosses state boundaries, such as pipelines and electric power transmission lines. Federal agencies also determine the conditions under which the private sector can develop resources on public lands, such as the Outer Continental Shelf and national forests. Those review processes generally aim to limit damage to health and the environment from economic activity, but they also affect the amount and pace of investments in the energy sector. For example, the federal approval process may delay or prevent the launching of projects that, if ultimately approved and undertaken, would result in significant investment and production. In addition, the prospect of such delays and the risk of projects' being blocked deter some projects from being proposed at all.

The federal government could increase employment and output during the next few years by hastening or relaxing the approval process for energy projects or by expanding opportunities to develop resources on public lands. However, the short-term effects of such changes would probably be small relative to the size of the overall economy for several reasons. First, state and local governments strongly influence the siting of energy facilities within their boundaries, and the federal government does not control the actions of those governments. Second, even if additional projects were approved in the next few years, many of them would not commence in earnest for several years. Finally, energy production accounts for only a small percentage of overall output, so incremental gains in that sector would have only a modest effect on the economy as a whole.

Another set of federal regulations that might be changed are environmental regulations. Consider, for example, the Environmental Protection Agency's (EPA's) regulations regarding emissions from coal-burning power plants, industrial boilers, and process heaters (such as industrial furnaces used in steelmaking). The regulations—designed primarily to meet the requirements of the Clean Air Act—pertain to hazardous air pollutants (including mercury) and emissions of sulfur dioxide and nitrogen dioxides, which help create airborne particulates and ozone. Those regulations demand costly investment during the next few years in scrubbers and particulate filters, especially at certain older power plants that lack emissions controls. EPA has estimated that regulated firms might make more than $50 billion in capital investments, spaced out over several years, to comply with the requirements. Delaying or eliminating those regulations would result in firms' delaying the investments in scrubbers and particulate filters they would otherwise have undertaken during the next few years, which would tend to decrease investment and output.

However, if those regulations were eliminated or their implementation delayed, firms might, instead, make additional investments in other equipment. Moreover, the reduced cost of production stemming from the lessening of regulation would increase the returns from investing in this sector and might thereby prompt other investments. Also, delaying or eliminating those regulations might boost spending by businesses and households by postponing or obviating an increase in the price of electricity that would otherwise occur, thus raising the return on investment of businesses that purchase electricity and increasing other purchases by households.

On balance, CBO expects that delaying or eliminating those regulations regarding emissions would reduce investment and output during the next few years, because the response to the factors that would tend to boost investment under those circumstances would probably be smaller than the response to the factors that would reduce investment. One reason for that conclusion is that the amount of investment in power plants other than that spurred by those regulations is expected to be relatively small—adding less than 1 percent to total generating capacity each year between 2013 and 2035, according the Energy Information Administration. Another reason for that conclusion is that the price increases that will probably result from those regulations—EPA estimates that one of the regulations will increase customers' electric bills by about 4 percent—are not expected to occur for several years, so they probably will not have an appreciable effect on household spending in the next few years.

Another possible approach to increasing investment in the energy sector in the next few years is to reduce uncertainty about future energy and environmental regulations. For example, quicker rulemaking by federal agencies might speed investment by affected firms, other things being equal. However, quicker action might increase the likelihood of errors in the process. Moreover, when markets have already adapted to an existing policy, and a change in policy would require agencies to revise regulations in the future, such a change might lead to greater uncertainty and therefore decrease investment until it became clear how the new policy would be implemented.

The Financial Sector. Changing certain regulations that push up borrowing costs and reduce access to credit for some borrowers could increase investment, consumer spending, output, and employment during the next few years. Such regulations are typically instituted in an effort to improve the safety and soundness of the financial system and thereby reduce the risk of financial crises of the sort that the nation recently experienced. As a result, any short-term economic benefits of loosening or repealing financial regulations may involve trade-offs with the potential cost of hindering progress toward those other goals.

Last year's major financial legislation (the Dodd-Frank Wall Street Reform and Consumer Protection Act [P.L. 111-203]) will have significant effects on the government's regulation of the financial sector, and one possible policy change would be to repeal or modify that legislation. CBO has not estimated the effects of such actions on the economy over the next two years or in the longer term. One specific aspect of that legislation that might be changed would be provisions that could lead to regulations raising capital requirements for banking institutions. Higher capital requirements will increase costs for those institutions, and those higher costs—to some degree—will be passed along to borrowers in the form of higher interest rates. A higher cost of borrowing will reduce investment. However, for two reasons, repealing or postponing implementation of the provisions of that legislation leading to higher capital requirements might not affect borrowing costs and investment very much in the next few years. First, financial regulators might increase capital requirements even in the absence of legislation—for example, as part of the Basel Capital Adequacy Accord (Basel III) negotiations for a revised international regulatory framework for banks—unless a new law expressly forbade such a change.[48] Second, banking institutions might increase their capital in response to market pressures even in the absence of the legislation (and, indeed, many have already increased their capital).

Legislative changes in financial regulatory policy might also affect investment by altering the degree of uncertainty about such policy. For example, reversing certain provisions of the Dodd-Frank legislation would reduce uncertainty about the new regulations that might be instituted to comply with those provisions. However, making further changes in regulatory policy so soon after the major changes enacted last year might accentuate uncertainty about future regulatory policy.

The Health Care Sector. The federal government affects health care spending and the provision of health care services in many ways. Examples include the Medicare and Medicaid programs, tax preferences for employer-sponsored health insurance, outlays for veterans' health care, investment in medical research, and the regulation of health care products such as drugs and medical devices. Last year's major health care legislation (the Patient Protection and Affordable Care Act of 2010 [P.L. 111-148] and provisions related to health care in the Health Care and Education Reconciliation Act of

48. The Basel Committee on Banking Supervision provides a structure through which developed countries can cooperate on issues relevant to supervising banks, including setting capital requirements. Regulators in each of the participating countries decide whether and how to implement the standards set by the committee. The implementation of increased capital requirements under Basel III is to be phased in over six years.

2010 [P.L. 111-152]) will fundamentally alter the market for health insurance and employers' options and responsibilities for obtaining health insurance for their employees over the next several years.

One possible policy change in this area would be to repeal or modify last year's health care legislation. CBO has not estimated the effects of such actions on the economy over the next two years.[49] Such an analysis would be difficult and highly speculative because many of the provisions of that legislation will not go into effect until 2014, and so, much of the legislation's economic impact in the next two years will stem from businesses' and people's expectations and uncertainty about what will happen if and when the legislation is fully implemented.

Specifically, repealing or modifying the legislation would probably have a variety of effects on investment, employment, and output in the near term. For example, the law provides an incentive for expansion in the health care industry to meet the higher demand for health care services that will arise from the greater number of people with health insurance. However, the legislation also lowers Medicare's payment rates for certain health care services, which reduces the incentive for certain investments in the health care industry. Whether the net effect of those aspects of the legislation is higher or lower investment in the health care industry during the next few years is unclear, and therefore whether repealing or modifying the legislation would raise or lower such investment in the near term is unclear as well. The legislation might also affect investment and hiring outside the health care industry by changing businesses' expected spending on employer-sponsored health insurance and thus businesses' expected labor costs. However, changes in businesses' spending on health insurance for their workers will probably be largely offset, for most workers, by changes in other forms of compensation for those workers; that is, changes in businesses' spending on health insurance will alter the mix of compensation but probably not have a significant effect on overall labor costs for most workers.[50] Therefore, CBO does not expect that the legislation will have a large effect on investment and hiring outside the health care industry during the next two years.

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49. CBO has analyzed the effects of that legislation later in the coming decade on individuals' decisions about whether and how much to work and employers' decisions about hiring workers. The agency estimates that the legislation will, on net, reduce the amount of labor used in the economy by a small amount—roughly half a percent—primarily by reducing the amount of labor that workers choose to supply. If the legislation did not affect the average number of hours worked per employed person, CBO projects that it would reduce household employment in 2021 by about 800,000. However, because the legislation will probably affect average hours worked among those employed, the effect on employment will be somewhat different. The reduction in the amount of labor used in the economy is largely attributable to the substantial expansion of Medicaid and the provision of subsidies that will reduce the cost of health insurance for some people; those provisions of the legislation will not go into effect until 2014. For further discussion, see Congressional Budget Office, *The Budget and Economic Outlook: An Update* (August 2010), pp. 48–49.

50. Some exceptions to that general statement are discussed in Congressional Budget Office, *The Budget and Economic Outlook: An Update* (August 2010), pp. 48–49.

Repealing or modifying the legislation could also affect the economy in the next few years by changing households' and businesses' uncertainty about the future. The cost and availability of health insurance has long been a source of considerable uncertainty, and some provisions of the legislation reduced aspects of that uncertainty. At the same time, there is currently a great deal of uncertainty about how the law will be implemented and how the health insurance market, the health care market, and the labor market will respond to specific provisions of the legislation—such as the mandate for individuals to purchase health insurance, the penalties for employers that do not offer appropriate coverage, and the reductions in certain payment rates under Medicare. Therefore, repeal or modification of the legislation would increase certain aspects of uncertainty and remove others. To the extent that such changes, on balance, reduced uncertainty, they would probably boost spending, investment, and hiring in the next few years; to the extent that such changes, on balance, increased uncertainty, they would have the opposite effects.

International Trade. Recently enacted free-trade agreements with South Korea, Colombia, and Panama are expected to increase investment and hiring by U.S. exporters and by businesses facing lower prices for the imported goods and services they buy, and to increase spending by households facing lower prices for the imported products they buy. However, investment and hiring by some businesses whose products compete with imports could be reduced.

Further free-trade agreements would tend to have similar effects. Over the long run, the net effect of such free-trade agreements on U.S. output is probably positive. During the first few years, however, further agreements' effects on output or on employment could be either positive or negative because of temporary dislocations as economic activity shifted between industries and firms.

In any event, agreements with individual countries would generally not have much effect on the overall U.S. economy in the next few years. That is the case partly because trade between the United States and most other individual countries is a small share of U.S. economic activity. And it is the case partly because the development and approval of free-trade agreements is usually a multiyear process, and even once agreements are implemented, industries' and firms' adjustments in response tend to take several years.

Chairman CONRAD. Thank you for your testimony. Thank you for your work.

Let us go back to the conversation Senator Sessions and I were having as we began this hearing, because I think it is an important conversation, it is an important debate. In many ways, the biggest regret I have this year is that we did not have this fuller discussion and this fuller debate, because the country needs it and I think this body needs it. And so let us go back to that conversation we were having.

Senator Sessions and I began this hearing by agreeing on the danger of our longer-term debt situation. I have said many times to my colleagues that the debt is the threat long term. Do you see danger in our long-term debt situation? And if so, what form does that danger take?

Mr. ELMENDORF. As you know, Mr. Chairman, under current policies, U.S. fiscal policy is on an unsustainable path. Federal debt is already very high relative to our total output compared with our historical experience, and it is on a path under current policies to continue to rise, and that cannot go on indefinitely.

The costs of that are manifold, partly that rising debt crowds out private capital investment and reduces future output and incomes. Also, that extra debt needs to be serviced. We need to pay interest on it, and that crowds out future Government spending or forces increases in future taxes.

The run-up in debt also means that policymakers have less flexibility in responding to unexpected developments, international crises or crises at home. And beyond all that there is an increasing risk as debt rises of a fiscal crisis in which investors will lose confidence in our Government's ability to manage its finances, and thereby the Government will lose the ability to borrow at affordable rates.

When that sort of crisis might hit we cannot predict. It depends not just on the level of debt at a point in time, but on expectations, and expectations not just under sort of current law or current policies, but also a sense of the ability of the political system to confront the Nation's fiscal challenges and make deliberate choices to try to stay out of danger.

Chairman CONRAD. Well, I think you said that very well, and I agree with that. Senator Sessions, I will not speak for him, but he has made clear how serious he believes this debt threat is.

So how could it be that there would be any benefit from fiscal measures taken now that would increase our debt?

Mr. ELMENDORF. I recognize that it may seem like a paradox that rising levels of debt are bad for the economy in the long run but, nonetheless, if used in certain ways, as we are talking about in our testimony, could be good for the economy in the short run. But it is not really a paradox. It simply recognizes that the nature of the economic challenge that we face as a country is somewhat different over the next few years than it is over the medium run or long run. Over the medium run or long run, economists in general agree that the restraint on our output and our incomes is the capital stock, it is the quantity and quality of our labor force, it is the level of technology and the way we bring these inputs together in businesses.

But in the short term, again, most economists agree the constraint on our output and incomes today and next year and the year after that is principally in the weak demand for goods and services. We have the factories and equipment to produce more. We have people who would like to work to produce more. And the reason they are not fully employed is a lack of demand for goods and services.

So in the short term, what can strengthen the economy in our analysis and the analysis, I think, of a broad consensus of economists, what can strengthen the economy is cuts in taxes or increases in spending because those can either spur public demand for goods and services or through lower taxes spur private demand for goods and services. And that can help in the short term. But in the medium term and long term, surely enough that would be counterproductive. And even if one does this in the short term and gets a short-term boost, unless one offsets that extra accumulation of debt, then one will be a little worse off in the long run than otherwise.

There are various complicating forces around that. It matters what you spend money on today, publicly or privately. It matters how you address the long-term fiscal challenge, of course. But as a general rule, the extra amount of debt that would be accumulated under policies of the sort that we have analyzed here would be bad for the economy in the near term and long term even though it would provide a boost to output and employment in the short term. And it is not really a paradox. It really just reflects the nature of the economic challenge, which is different at different points in time.

Chairman CONRAD. All right. I thank you for that explanation.

Let me go to some of the specifics of what is in your study because I think it is very important to understand that. Let me just say I noticed there is a difference between what is in this study and the previous study in that, as I understand it, this is looking at a 2-year effect, the previous study was looking at a 5-year effect. Is that correct?

Mr. ELMENDORF. The previous study looked at a 1-year, 2-year, and 5-year horizon.

Chairman CONRAD. Okay.

Mr. ELMENDORF. We focused in this case on the 2-year horizon.

Chairman CONRAD. When you looked at 5-year, infrastructure was much higher up on the list in terms of bang for the buck.

Mr. ELMENDORF. Yes.

Chairman CONRAD. Here, when you are looking at a shorter time horizon, infrastructure drops down, and these other more short-term measures—increasing aid to the unemployed, providing refundable tax credits to lower- and middle-income households, reducing employees' payroll taxes, subsidizing the interest rate on certain mortgages that are refinanced—those things move up in relative position.

Let me just make clear my own bias. I tried very hard when we were doing stimulus to have more infrastructure. I argued strenuously for a package of $200 billion of infrastructure, largely focused on transportation. The argument made then against it was from analysis that we are seeing here, that is, it takes longer to get in-

frastructure spending into the bloodstream. My argument was that after a fiscal crisis you are going to have a downturn that lasts longer; therefore, having something that hits later, not a bad thing, maybe a good thing. I wish that view had prevailed then because we are in a longer-term period of weakness.

So tell me about infrastructure. Why in your analysis, when you shift from a 5-year focus to a 2-year focus, does infrastructure drop down in terms of bang for the buck?

Mr. ELMENDORF. You have it just right, Mr. Chairman, that if we had shown here the 5-year effects, infrastructure would have looked relatively better for just the reason you say, which is that that money takes some time to get out the door. And certain projects, as we know, can happen fairly quickly—repaving of roads can be done fairly quickly—but more substantial projects generally take years to complete, and the money basically is spent over the course of those sets of years.

Chairman CONRAD. Could I just ask you this question? Do you know how long it took to build the Pentagon?

Mr. ELMENDORF. They did that very rapidly. That was an unusual experience under unusual circumstances, as you know, Mr. Chairman.

Chairman CONRAD. You know, that is the argument I made in this circumstance. We were in an unusual circumstance in 2009, and the answer to the question is it took 9 months to build the Pentagon. Nine months. Now we seem to think we cannot do things, and in part, we have done it to ourselves. I can tell you, in my State we are having an energy boom of incredible proportion. We are now the fourth largest oil producer in the Nation, and we are headed for second or third. And I will tell you what: We have a need for thousands of people to work in North Dakota right now. We need thousands of people to work there. Why aren't they there? Because they do not have a place to live.

I just was in Williston, North Dakota, in the heart of the oil boom. I had a school administrator tell me she has 14 children who come to school there every day who are living in their parents' vehicles. They do not have a place to live.

Senator NELSON. What is your unemployment?

Chairman CONRAD. Our unemployment is the lowest in the Nation. It is less than 2.5 percent.

We have a need for thousands of people to work. We need to build roads. It takes over 1,000 truckloads, some tell me 2,000 truckloads to do one well. And our roads are clogged. People are dying on our roads. And these are two lane roads right through the heart of oil country. We need to build roads. That could employ thousands of people. My God, let us get to it. And this idea that we cannot do anything, we cannot get the money out the door—I know in normal times we cannot get the money out the door. When do we go to a serious footing of let us get it done?

You know, I believe deeply in my State, if somebody would help us get some of the things that we normally would do in normal order of business, we would get out of the way, we could get a lot done. I will let you respond. I have used my time. Then we will go to Senator Sessions.

Mr. ELMENDORF. I think you are right, Senator, that it depends crucially on what else you get out of the way. Projects will generally require bidding. There are reviews of various sorts for environmental purposes and others, and that is part of why I think it does take longer today to complete large projects than it did when they built the Pentagon.

You are also right, though, that under our forecast and the forecast of most private sector people, and quite consistent with the evidence from Reinhart and Reinhart you cited, we expect there to be a shortfall in demand for goods and services and still excess numbers of unemployed people well beyond the 2 years that we focused on in these particular calculations.

We had the unemployment rate coming back down to close to 5 percent only by 2017, I think, in our August forecast, which is 6 years from now. So there can be justification. It depends, of course, on the priorities of you and other Members of Congress. But there can be a macroeconomic justification for continuing to have that sort of impetus to spending out for an entire 5-year period.

Chairman CONRAD. Senator Sessions.

Senator SESSIONS. Thank you. Well, with regard to this chart that you provided to us, it is important to note it is just 2012 and 2013, and, for example, on infrastructure improvement, it would not be complete then, so you would have some productivity gains in the out-years, correct?

Mr. ELMENDORF. Yes, that is right.

Senator SESSIONS. In one sense, this is a misleading thing because you tend to favor immediate expenditure items like reducing payroll taxes or unemployment insurance. That money goes out immediately. So this chart has some misleading characteristics to it if you are looking at a longer period of time. Is that correct?

Mr. ELMENDORF. Well, the question you ask does influence the answer that we can provide for you, Senator. I think the primary difference between what this chart looks like and what a chart over 5 years would look like is the one that the Chairman pointed out; the infrastructure spending would move up. If one looks back at our table from the report last January, most of the other items have roughly the same ranking of cost-effectiveness over the 5 year span as over the 2-year span.

Senator SESSIONS. One thing that is really important, I think, is that you note in your report on page 25, as a result of your ongoing review and relevant research, CBO has reduced the lower end of its range of estimates, the short-term, effects of changes in fiscal policy on output and employment, while leaving the upper ranges unchanged.

So basically your experience perhaps with the first stimulus made you less optimistic about how large the short-term benefit would be from borrowing and spending today.

Mr. ELMENDORF. It is not so much our experience with the Recovery Act, Senator, as the review of the literature and the evolution of the economics literature. There is some new research based on the experience of the past few years, but most of the research on which we and others are drawing——

Senator SESSIONS. All right. Okay. Whatever you—some of that research is probably based on the stimulus, I would hope, which

did not achieve the goals that we hoped for, in my opinion. But, you know, I was in Evergreen, Alabama, and an African American stood up at the town hall meeting and said, "As my granddaddy always said, you cannot borrow your way out of debt." We are in deep debt today, and we are making proposals to fix our debt crisis by borrowing more money.

Now, the President's proposal did call for a tax increase to pay for this $450 billion increase, did it not?

Mr. ELMENDORF. We did not study the economic effects carefully, but, yes, you are right about that, Senator.

Senator SESSIONS. And an increase in taxes has some negative effects on the GDP growth, does it not?

Mr. ELMENDORF. Yes, although the amount, of course, depends on the nature of the tax increase, and as I said, we did not study the economic effects of the President's proposal.

Senator SESSIONS. And with regard to your letter to Senator Gregg that the 10-year stimulus package would have a net negative on growth over 10 years, I recall asking Secretary Geithner about that, and he seemed to be surprised, did not think how it was possible you could spend $800 billion and not have improvement over 10 years. But do you still adhere to the view that there would be a modest GDP reduction as a result of the stimulus package that did pass?

Mr. ELMENDORF. What our letter said, Senator, was that the effects on the level of GDP at the end of the 10-year window would be negative. GDP would——

Senator SESSIONS. So there would not be as much GDP growth at the end of the window as there would have been without the bill passing.

Mr. ELMENDORF. Let me be clear. Our estimate of the cumulative growth in GDP over the 10 years from that legislation was positive. What we said was that there would be a big boost to the level of GDP in the first 3 or 4 years, and then that—relative to what would have happened to GDP without that law, then the effect on GDP would go back down below zero. So the level of GDP—I am sorry. The level of GDP would be a little lower at the end. So I am sorry. So the—let me be more careful. The level of GDP is a little lower at the end. That is a net negative effect on the growth of GDP——

Senator SESSIONS. And in the next 10 years, since you are carrying that debt and paying interest on it and the stimulus value is long since gone, it would be a continual negative of some effect on——

Mr. ELMENDORF. Yes, it would represent a drag on the level of GDP beyond that if no other actions were taken. That is right.

Senator SESSIONS. You noted the effectiveness of deficit reduction. You released a report earlier this year, "The Macroeconomic Budgetary Effects of an Illustrative Policy for Reducing the Budget Deficit," and it concluded that a set of policies that would reduce the deficit by $2 trillion over the next 10 years would increase long-term economic growth by as much as 1.4 percent. Is that still your view?

Mr. ELMENDORF. Yes, it is. Again, it would raise the level of GNP at the end of the decade by something between 0.6 and 1.4 percent.

Senator SESSIONS. And I guess it is axiomatic that in the abstract lower debt helps an economy be more vibrant and would improve GDP.

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

Senator SESSIONS. One of the things that the United States has worldwide is our currency is a reserve currency throughout most of the world. Is that an advantage for our economy?

Mr. ELMENDORF. Absolutely. Yes, Senator.

Senator SESSIONS. Well, I just looked at this week's Barron's headline. I do not know if you have seen it. "The world's next reserve currency," and on the cover of Barron's is the Chinese yuan. And it says, "By 2020"—that is not too far off—"expect China's yuan to be widely used alongside the weakening euro and dollar in international trade as a store of value." Would you agree that that is not a positive development for the United States economy?

Mr. ELMENDORF. Yes, I would not make predictions about how quickly the U.S. dollar might be supplanted as the reserve currency, but certainly if the U.S. dollar were supplanted as a reserve currency, that would be costly for our economy.

Senator SESSIONS. And part of that is a concern of our debt, and our trade deficits, but specifically as to our debt, the American debt is a factor in the worldwide concern over the United States dollar as a reserve currency, is it not?

Mr. ELMENDORF. Yes, absolutely.

Senator SESSIONS. And fixing that would help strengthen our currency, reducing our debt would improve the viability of the United States dollar as a reserve currency.

Mr. ELMENDORF. Yes, Senator.

Senator SESSIONS. Would you share—basically, Senator Conrad suggested this, and I think it is good—some of the things that benefit the United States economy as a result of the dollar being a reserve currency?

Mr. ELMENDORF. Well, one thing that we have seen very clearly in the last few years is that in moments of great worry by investors around the world about the safety of different investments, they come to the United States with their money, viewing us as a safe haven.

Additionally, a lot of transactions are conducted in dollars, and that demand for our financial assets helps to keep the United States financial system at the center of the global financial system even when our own financial system is struggling, as it has in the past few years. And as you said, that is one—we risk losing that advantage if we allow our debt to continue to rise relative to GDP.

Senator SESSIONS. And we have the ability to print more dollars within a limited range before adverse impacts occur. But if that goes too far, that, too, could be a part of the devaluing of the currency and the loss of confidence in it, is it not?

Mr. ELMENDORF. Yes. If our inflation rate returned to the levels it was at in the beginning of the 1980s, for example, that would also weaken the dollar's role in international financial transactions.

Senator SESSIONS. Thank you.

Chairman CONRAD. Thank you, and I thank Senator Sessions for asking that. I think it was very important we get that on the

record, the role of America's reserve currency, as a reserve currency, the importance of it.

Senator Begich.

Senator BEGICH. Thank you very much, Mr. Chairman, and I want to—I appreciate the debate you guys had a little bit earlier before we started the hearing, actually, and I thought it was interesting listening. But I guess I will, first of all, make a couple of statements, and then I will have some specific questions.

We can argue the recovery bill added debt. So did the two wars added debt. So did the unpaid tax program for millionaires and billionaires added debt, unpaid for. We are paying for it now. We will pay for it forever, it seems, at the rate we are going. So, I mean, I like debating history, but that is irrelevant to where we need to get going here.

I appreciate the debate, but where we are today is we have an economy that, you know, we could argue if that recovery bill did not happen, would we have more unemployment? Would we have—you know, every month, we can argue if the number is strong enough. But since I have been here, in 2009, when I got sworn in a month and a half later, we have had positive job increase every single month. Now, it could be varied. Some was very small. Some was significant. But we could argue that without that short-term recovery bill, that number could have gone the reverse. We do not know that. That is the great mystery of the work you have to do as an economist and as someone who works with all these numbers. But the fact is I could predict that before, you know, in 2008, we were averaging in the last quarter 500,000, 600,000 jobs lost a month. A month. Now we are at least in a positive territory. We would argue that 9 percent is a rate we do not want, which I agree, but it is actually somewhat stagnant right now, which is a good sign. It is stabilizing. Now, we could argue 9 percent is not something we want to stabilize on, but the fact is it is not going this way as it was doing as we were moving through 2009 and the beginning of 2010. It was just going click, click, click. Now it has stabilized.

We have certain segments—again, we could argue if this worked or not, but I would argue the automobile industry was the walking dead 2 years ago—or driving dead. And today the American auto industry is thriving. As a matter of fact, the Wall Street Journal had a great article. The headline was, "Automobile industry imports jobs from China." That is a reversal. We have more activity. They are the strongest company since 1998, profiting.

So we can argue the theory which could have happened, should have happened, whatever, but the fact is here we are. Unemployment is more stabilized. GDP is not where we want it to be. The auto industry as one great manufacturing industry of this country is moving up, selling more vehicles. We have importation of jobs from China.

I can tell you in the seafood industry, which is important to Alaska, some of the processing that has been going on in China is moving back to the United States. Because as the middle class grows in China, what happens? Wage rates go up. Fuel costs are high. It is better to do it here.

So you can look at pieces and draw your own conclusions, but we are where we are. We have got to get the unemployment rate down. We have got to get consumer confidence higher.

Let me take off on the issue. I agree with the Chairman in regards to—of course, he hit my issue: energy. His State is now recognizing, I think, in a robust way the power of energy and the development of energy. You mention actually in your testimony fuel costs have a direct impact to consumers, but also development of domestic supplies, as you just heard, have not only an effect on the jobs in the oil patch States, but a ripple effect as you build roads and infrastructure in schools and hospitals and facilities that service this industry. And I guess I would love if you could just add a little bit to your comments around energy.

I agree. I mean, the Pentagon was built in 9 months. Disneyland in California was built in 1 year, a whole city, when you think about it. Can we do this? I will tell you, when I was mayor of Anchorage, we built a $100-plus million convention center in about 24 months from the date of the idea—not drawn up, but the date of the idea—to completion, which involved bonding, voter approval, and construction, design, bid, everything. So anything is possible if we want to do it.

Tell me some thoughts on the energy sector and what we can be doing. Obviously, I am biased. I think we should be opening ANWR and NPRA and Chukchi Sea and Beaufort Sea. These are hundreds of thousands of opportunities of jobs throughout this country over the long term. Give me your thoughts there, if you could. I did not mean to go on there, but I got a little—you know, we spend a lot of time talking about what could have happened, should have happened. We are where we are. Democrats and Republicans are to blame on both sides, past Presidents, current one, everyone. It is now time to get busy and get some stuff done around this place. That is what the American people are saying to me every day. That is what Alaskans are saying to me every day, and energy is one of those great opportunities from two-fold—and if I could just say one more piece, from an economic security but from a national security, we have enormous resources spent overseas to protect oil flow when we could be spending it here in this country building our economy up.

Mr. ELMENDORF. Senator, our focus in this testimony was on the short term, on the next few years, and the points we note about efforts the Federal Government might make to encourage investment in energy is that those effects are likely to not have a big impact on the overall economy in the next few years, partly because—and I think you mentioned this in a way in talking about your experience before coming to the Senate—State and local officials have a very important role to play in deciding energy facilities in what companies are able to do. So the Federal Government can open up certain areas that are now closed, but it cannot just easily sweep away all the other factors that affect the pace of energy expiration. That is part of it.

Secondly, even if a decision were made and all the approvals were granted to begin drilling in a certain spot right now, that takes some time to happen. So at the moment most of the rigs that are designed to drill, for example, in deep waters offshore are com-

mitted to be somewhere in the near term. And if more space was opened up for further exploration and drilling, then over time, of course, that would lead to more drilling in those places, but not, we think, of a magnitude in the next few years to affect the overall economy.

That is not to say those things are good or bad to do. There are lots of other factors that can weigh in that decision, as you mentioned. But the focus here was really just on the short-term impact on the overall economy.

Senator BEGICH. Right, but I would argue with you that just the idea of development—I will tell you, in the 2 years since I have been here, there has been at least some renewed interest in the Arctic, just that alone, a couple of industries have hired well over several hundred employees just to start the analysis of what is possible, or Shell, who just is in the process of finishing a ship that was being constructed in the last year and a half, I mean, it is built in Louisiana, it is being shipped, now it is in Seattle ports. These are hundreds and hundreds of jobs, well-paying jobs. And so I would argue how we define short term, we have to be careful that it is—do we want, for example, energy production to be happening? Yes. But 3 years ago, North Dakota, I mean, you know, I will tell you, my mother would drive from Minnesota to Carson City, Nevada, where she lived. She would go through North Dakota, no problem finding a place to stay, a hotel. She went through there this summer. No such luck. She had to keep driving. Now, she is in her 70s, and driving late at night is not the best thing a son would like to have her do. But I will tell you, in 2½ years the short-term development in that State as an example—so I would just—and I did not mean to get on my energy rant, but maybe, Mr. Chairman, we could—I just think that energy, both non-renewable and renewable, is an incredible short-term and long-term opportunity that we have underestimated in this country, and we continue to spend billions with countries that hate us in order to get energy supplies to this country. It makes no sense to me. So maybe as a budgetary discussion—I will tell you, Chukchi Sea, Beaufort Sea, ANWR, these are just the Federal treasury reaping the benefits of development in the hundreds of billions of dollars. Hundreds of billions of dollars that is idle.

I guess hopefully maybe we will have a broader discussion. I did not mean to rant on energy, but the Chairman triggered me, because we do not want to be number three in energy production. North Dakota is about to take us over here. We are working to be number one.

Let me end there.

Chairman CONRAD. Let me just say I agree entirely with the Senator. Maybe it would be useful in this Committee to have an energy hearing because it has got huge budget implications. Huge.

Senator BEGICH. Absolutely.

Chairman CONRAD. Senator Johnson.

Senator JOHNSON. Thank you, Mr. Chairman. I have got to hop in on the energy bandwagon here. This is not a mystery to me why we are not creating jobs and why are our economy is not growing. As a business person, I was actually making those investment decisions for 31 years. You take a look at our regulatory environment.

You want an answer why we cannot build the Pentagon in 9 months? Because of all the regulations. Try to build something in this country. Do you think we could do the Hoover Dam again? Why did President Obama kick the can down the road on the Keystone XL pipeline? Why aren't we drilling in ANWR? Government regulation. We are killing ourselves. We are doing it to ourselves.

So I guess when I take a look at your testimony, with all due respect, I could not disagree more with your conclusions. My own experience, again, in making those investments decisions, if you allow business owners to keep more money, they will invest it. Recent history in terms of short-term stimulus, isn't it true that basically what happened with a lot of those stimulus dollars is consumers, because of their fear, basically just deleveraged? They did not really stimulate the economy. Isn't that by and large correct?

Mr. ELMENDORF. We expected that some of that money would be saved. It is hard to know in retrospect exactly what happened in that episode because we cannot track those particular dollars through particular households.

Senator JOHNSON. But we can see that we already did a payroll tax holiday. We have extended unemployment benefits. And it has not worked. All we have done is we have incurred an additional $4 trillion worth of debt, another $1 trillion coming on board this year. And what is really preventing businesses from investing is the fear that, you know, the end result of all the debt and deficits—I mean, when Government spends more money than it has, we know as business people that eventually Government is going to take—they are going to tax you more or they are going to create inflation, and that is why the business community is simply not investing. Don't you basically agree with that conclusion?

Mr. ELMENDORF. Senator, we believe and have written and I write in this testimony that uncertainty about future Government policies, future tax and spending policies, future regulatory policies are a factor that is restraining businesses' decisions to invest and hire and households' decisions to spend. But we do not think that is the principal factor.

For example, surveys of small business people done by the National Federation of Independent Business shows that the main difference in the obstacles that businesses report themselves facing today relative to a few years ago is a weakness in demand for their products.

Senator JOHNSON. Because everybody is afraid of a European contagion, that the exact same thing is going to happen in the United States as is happening in Greece and Italy. They are afraid of that. Again, what I want to concentrate on is the debt and deficit, and I want to talk about the real risks that I do not think we are really acknowledging now in this country.

Let us first start out by not achieving the growth targets the CBO estimates, and I have no idea how you come up with your estimates. I am assuming in this analysis you used similar estimates that said we were going to grow at 3.1 percent this year, and we are not going to achieve that growth. I think your estimate is for every 0.1 percent reduction in growth, we add $310 billion to the 10-year——

Mr. ELMENDORF. That sounds right, Senator.

Senator JOHNSON. So if it is only 1 percent less, that is $3.1 trillion in additional deficits over 10 years, correct?

Mr. ELMENDORF. Yes.

Senator JOHNSON. I have seen other studies. If we only grow at 2.5 percent in the next 10 years, that will add $5 trillion to our debt and deficit. That is a significant risk, correct?

Mr. ELMENDORF. Oh, yes, no doubt. And you can see in the pictures we showed today, we have very wide bands in our estimates for each of these policies because we recognize the uncertainty of the analysis that we are doing.

Senator JOHNSON. Not a whole lot of people are talking about that very significant risk. Why is that? Are we just afraid to acknowledge it because all we are doing—all we are doing in the Super Committee is trying to come up with $1.2 trillion in the reduction in the rate of growth and spending.

Mr. ELMENDORF. I guess, Senator, from my perspective, people are talking about that risk. They have not reached agreement in the Super Committee, as far as I know, and the Congress has not enacted some legislation to reduce deficits by more than was done in the Budget Control Act over the summer.

My sense, actually, is that people are talking about it a lot, but that agreement on how to address it remains elusive.

Senator JOHNSON. Well, people are certainly fearing it.

Let me go to another area of significant risk, and this is exactly going into CBO projections, which I just think are totally wrong when it comes to the health care act. According to CBO, only 3.6 million people were estimated to lose their employer-sponsored care and get dumped in the exchanges. How did you ever come up with 3.6 million people? What economic model came up with that number?

Mr. ELMENDORF. Our model takes account of incentives facing households and businesses to get insurance coverage through various possible avenues, and other people who built models of the health insurance market have actually reached rather similar conclusions to ours about the effects of the health legislation. That includes the actuaries at CMS, researchers at the Urban Institute, at RAND, and other places. And it does surprise many people that we do not show a larger loss of employer-sponsored insurance coverage.

I think it is worth remembering here that most people now receive and will continue to receive a significant subsidy to buy health insurance through their employer through the Tax Code, and for most——

Senator JOHNSON. Let me just stop you. Have you seen your predecessor Douglas Holtz-Eakin's decision matrix which just proves conclusively that economically it is in the employers' and the employees' best interest for 35 million people to get dumped off their employer-sponsored care and get put in the exchanges? Have you seen that study?

Mr. ELMENDORF. We have seen his analysis, but we reach a very different conclusion. And as I was saying, for most workers they would get no or smaller subsidies through the new insurance exchanges than they receive through the Tax Code. They do not have an incentive to go to the exchanges.

Senator JOHNSON. His analysis would have increased our deficit in the first 10 years by over half a trillion dollars, in the second 10 years $1.4 trillion. When I saw that decision matrix, as somebody who has bought health insurance for 31 years, I called him up and I said, you know, "Doug, this is a pretty good analysis, but you are still wrong." Let me run through what the real decision factor is going to be as an employer and, again, somebody who has been buying health care for years.

According to CBO, in 2016 the average cost of family coverage will be $15,000, which, by the way, is $2,100 more expensive than it would have been had we not passed the health care law. Let us put that aside. Fifteen thousand dollars. So an employer now is going to be taking a look at, well, I could pay $15,000 or I could pay a $2,000 penalty, and with the health care act I am no longer throwing my employees to the wolves. I am making them eligible for very large subsidies.

In the case of somebody making $64,000 a year—which is, by the way, $13,000 more than the median income—that is a $10,000 subsidy. Now, the fact of the matter is we have had the McKinsey study that showed 50 percent of employers that are informed are planning on dropping coverage very shortly after this health care act takes effect. When that happens, if that is half, 180 million people get their insurance through their employer-sponsored care. Half of them would be 90 million people at about a $4,000 subsidy. That costs us close to over $400 billion a year as opposed to the $95 billion. Isn't that pretty accurate?

Mr. ELMENDORF. So, Senator, you are right that employers who put their workers into the insurance exchanges would not be throwing them to the wolves in the same sense they would be without such exchanges in place. Nonetheless, their employees would then be forgoing a very large tax subsidy, and a majority of people, of workers, who would have employer-sponsored health insurance without that law would be eligible for no subsidy through the insurance exchanges, and they get a substantial subsidy through the Tax Code. So there is no reason for the firm to put them into the exchange. That is against the interests of the workers.

Senator JOHNSON. No, but it is in the interest of the employer. Again, the decision is $15,000 or pay $2,000 and make my employee eligible for a $10,000 subsidy. And, again, the surveys show employers that are informed, 50 percent right now are saying they are going to drop coverage. How can you continue to deny that and, by the way, as a result totally understate what our true risk and debt and deficit are going out 10 years? I mean, we are really misleading the American people on this factor.

Mr. ELMENDORF. I have to disagree with you, Senator. I do not think we are misleading the American people. There is a great deal of uncertainty around our estimates, and we have said that every time we have talked about them, I think. But it is not true that for most workers they are eligible for substantial subsidies through the insurance exchanges in the legislation.

Senator JOHNSON. Your own CBO spread sheets show that the average cost of the subsidy in 2021 will be $7,000. Of those 3.6 million people, the average subsidy——

Mr. ELMENDORF. For people who are eligible for subsidies, yes.

Senator JOHNSON [continuing]. Will be $7,000. But, again, the eligibility—well, we can go——

Mr. ELMENDORF. Those who are eligible——

Senator JOHNSON. I am past my time.

Mr. ELMENDORF [continuing]. Are a minority of workers. And we have read that survey. We have read other surveys that have reached different conclusions.

For what it is worth, when CBO estimated the effects of adding the prescription drug benefit to Medicare a number of years ago, we had to make an assessment about how many employers would stop providing drug coverage to their retirees and have their retirees only get drug coverage through Medicare. And shortly after we did the estimate, there were surveys in which a lot more employers said they would drop coverage than we had estimated. But, in fact, at the end of the day, fewer employers dropped coverage than CBO estimated. So surveys——

Senator JOHNSON. So just my final question——

Mr. ELMENDORF [continuing]. Are not always——

Senator JOHNSON. I understand, but in light of these surveys that say 50 percent, that is 90 million people, 50 percent. And you are going to stick to your 3.6 million estimate? You think that is a good estimate?

Mr. ELMENDORF. Senator, we are always evaluating our estimates and taking on board new information. In fact, we talked today already about revisions that we made to our estimates of the effects of the sort of fiscal policies we are talking about today. So we are not averse to changing our estimates when there is new evidence, and if there is new evidence that we find compelling, then we will make a change——

Senator JOHNSON. Okay. I would ask you to review that evidence, and I am sorry, Mr. Chairman.

Chairman CONRAD. No, I think it was a valuable exchange, and we need it. The country needs it. We have got to be—it is important to have this debate.

Senator Whitehouse.

Senator WHITEHOUSE. Thank you, Chairman.

Mr. Elmendorf, welcome.

Mr. ELMENDORF. Senator.

Senator WHITEHOUSE. If the debt of our country is so important—and I think it is pretty widely believed around the Senate that it is—and if that debt which is so important can be reduced from two sides—it can be reduced by spending less and it can be reduced by a revenue increase—if that is the fact that the debt is so important and you can reduce it either with increased revenues or with spending reductions, in that environment why is it so important that the highest-income Americans pay lower actual tax rates than regular working Americans actually pay? And to illustrate the point that the highest-income Americans pay lower actual tax rates than regular working Americans pay, I look at the IRS data for the top 400 income earners who earned over quarter of a billion dollars each and paid, I want to say, an 18.2 percent all-in Federal tax rate, and for Rhode Island at least, that equates to where a regular taxpayer hits about forty-some-thousand dollars in income, what a truck driver in Rhode Island makes. So you have

got the tax rate increases as your income increases to a point, and you cross through that 18.2-percent barrier and you hit about $40,000, which is, as I said, what a truck driver's Bureau of Labor Statistics average pay is in Rhode Island. And then you go out to the far end where people made over a quarter of a billion dollars, and they are paying the same 18 percent. Why is that so important to our economic prosperity that we have this Tax Code in which super-high end income earners are paying such low tax rates?

Mr. ELMENDORF. Senator, you ask the question as if I had said it was so important, so just to be clear, I do not think I have said the things that you are asking me to justify.

Senator WHITEHOUSE. Maybe there is a rhetorical cast to my question.

Mr. ELMENDORF. Perhaps. On the factual matter, I would say that by our estimate the average Federal tax rate, so all Federal taxes—income, payroll, corporate profits tax and so on—as a share of household income rises as one moves up the income distribution, and——

Senator WHITEHOUSE. To a point.

Mr. ELMENDORF [continuing]. In tables that we report every year or so, we go up to the top 1 percent, and we estimate the top 1 percent has a higher average tax rate than the top 5 percent, which is higher than the top 10 percent and so on.

Whether it is higher enough for your preferences I cannot judge. Economists think, with I think substantial evidence, that tax rates affect people's behavior and that higher tax rates on work come from labor and come from capital affect how much people work and save. So in setting tax rates, there are multiple objectives usually that policymakers are trying to balance and put different weights on.

Senator WHITEHOUSE. So is the IRS information wrong that shows that the 400 highest income earners paid only 18.2 percent in the most recent year, and the year before that that was most recently calculated, it was only 16.7 percent, which equates to a hospital orderly in Rhode Island? If you look at the famous Helmsley Building, which is big enough to be its own zip code—the IRS also reports by zip code—they were at 14.7 percent overall, and their doormen and their janitors paid higher tax rates. How does that square with your figures? Those are actual IRS reported dollar numbers.

Mr. ELMENDORF. I have not looked at that. I am confident that they are reporting accurately what they are reporting, so I presume there is some difference in what concept they are reporting relative to the concept that we are reporting.

It is true the last numbers we have released are for 2007, and I know from folks who have looked at their data that the incomes at the top have changed over the last few years. So maybe that is part of what changes tax rates in the past few years.

It is also possible that the IRS is looking only at certain taxes. Maybe that is just income taxes, and we are looking at the broader measure of taxes.

I do not know, Senator, but I am happy to have us look into that for you and see if we can explain the differences for you.

Senator WHITEHOUSE. Well, here is what interests me. We just went through a fairly considerable exercise here in the Senate trying to pass jobs legislation. We had the President's original jobs bill, and that was filibustered. And then we went through different elements of it, and until the veterans piece, they have all been filibustered. This was jobs legislation that would create real jobs. It was paid for. It was paid for so it would not add to the debt in any way. It was paid for in a way that required an additional contribution from Americans who were making more than $1 million a year but only on the income over $1 million a year that they were making. And over that point, it got filibustered.

Is there an economic rationale for stopping those jobs bills in order to protect the over $1 million income of over $1 million income earners? Does that work through CBO formulas to be a win for the economy when you have protected that income from taxation and cost the American economy the jobs that would have been created?

Mr. ELMENDORF. We did not analyze the economic effects of those bills, so I cannot be sure. My guess is that if we did analyze it, we would find that those bills would spur output and employment in the next few years because the stimulative effects of the additional spending would probably outweigh in our estimates the negative effects of the higher tax rates over the next few years, over the longer term, than the disincentive effects of higher tax rates would tend to—and the additional debt would tend to be a drag on the economy. And then one could weigh that off against the short-term economic gains. One can weigh that off against distributional objectives that one has in the longer run and so on.

Senator WHITEHOUSE. Let me close by observing, Mr. Chairman, that there has been a certain amount of criticism of the Reinvestment Act here for only having stopped the employment crash that President Obama inherited without having recovered from it. And I would say that clearly it would be better if we could have recovered from it more rapidly, but it is important, I think, that we stopped that jobs crash. I think we were at 700,000 to 800,000 jobs being eliminated every month in the middle of the jobs crash when the President took office. And just to bring it home to Rhode Island, for the 11,000 families that had a member getting a paycheck because of the Reinvestment Act, for the 11,000 families who had that paycheck and for the coffee shop and the grocery store and the toy store and the mechanic that they were all able to go and pay for goods and services from, we were actually glad that that Reinvestment Act took place. And I think those 11,000 families would feel that they had one heck of a worse time without it, and so would the communities around them who would not have received the benefit of their income as they went around and spent it in the way that people do.

Rhode Island is not a big State, and 11,000 folks with a job instead of being on the unemployment line, 11,000 families that got a paycheck instead of not, that is pretty real, and I think that we should not underestimate that.

Thank you.

Chairman CONRAD. Well stated.

Senator Wyden.

Senator WYDEN. Thank you, Mr. Chairman, and I commend you, Mr. Chairman, for a good hearing and an important one, particularly timely because of the Super Committee, and that is what I want to ask you about, Dr. Elmendorf, because, fortunately, in the Super Committee, one of the issues that is very much in play is the prospects of pro-growth tax reform. You and I have talked about it before, but I want to walk you through a different aspect of it because it goes right to the heart of this debate about stimulus, and particularly stimulus right now.

As you know, over the last 5 years I have had the chance to work with two colleagues on the other side of the aisle who would certainly call themselves conservatives—former Senator Gregg and Senator Coats—and Senator Begich. Two Democrats and two Republicans have worked on this for the last 5 years. And I want to talk about the stimulative effect of what would happen if tax reform was enacted certainly in 2013. In other words, there is discussion about the timing of 2012 and 2013, but let us talk about, say, 2013.

Under the legislation that I put together, a bipartisan effort, if you are a couple that makes $50,000 a year, $60,000 a year, $70,000 a year, you would get permanent tax relief—permanent tax relief—of $3,000 to $4,000 a year, the typical person, and that comes about largely because what we do is we triple the standard deduction for those families. So the couple now gets about $10,000, and it would triple to $30,000. So what that means for a couple making $60,000 or $70,000 a year, it in effect puts half their income off limits from taxation.

My sense is that that would be, based on your analysis at page 26 of the report, fiscal policy options for assisting households would be a pretty good stimulus for the economy if that was to be enacted so it applied in 2013. Do you want to walk me through that? Because it certainly ties to other things that you have said in the past in terms of business decisions with respect to investment and hiring depending on the demand for their products, and greater demand and production leads to more investment and hiring. That is sort of Economics 101. And it seems to me there would be significant stimulative effect in cutting income taxes permanently for those folks in those kinds of income brackets, $50,000, $60,000. And we would also do it for people making $30,000, $35,000 as well who would get significantly more tax refund in that legislation. But why don't you give me your assessment of the stimulative effects here?

Mr. ELMENDORF. As you know, Senator, we have not attempted to analyze the many economic effects that would arise from a comprehensive tax reform of the sort that you have developed. But you are right that reductions in taxes for households, especially if they were viewed as permanent reductions, would tend to spur spending by those households. Though further down the income distribution or the less wealth, less assets held by households, the more likely that extra income is to be spent. That is why we expect that increases in aid to the unemployed would have a particularly large bang for the buck. But for other households as well, additional income would tend to raise their spending.

Of course, we would have to keep track of all the aspects of your proposal to know how that would net out. But I think the channel you describe is certainly one that would take effect.

Senator WYDEN. Well, I appreciate that, and I think it is a fair comment. Part of the reason that I asked it—and you are absolutely right. When you look at comprehensive tax reform, you have to look at all the pieces of the puzzle. This is something that has not gotten much discussion in the overall debate about tax reform. Part of it, I guess, would be my fault because I probably ought to be mentioning it more often every time this topic comes up. But it has not been, you know, particularly controversial. But I do hope, particularly in light of your answer and what you say in outlining the options there on page 26, that people see this as an opportunity for real stimulus that would not raise the deficit, number one, but would generate more revenue, which, as you know, is something that your companion organization, Joint Tax, found with the legislation that I authored with Senator Gregg and Senator Coats.

Any sense of what families making $50,000, $60,000, $70,000 would do in terms of their purchases if their taxes were cut in the vicinity of what I am talking about, 50 percent? I mean, my sense is they would go out and make those kinds of consumer purchases, consumer durables that had a big economic multiplier. So let us have you analyze this in terms of the area you have looked at, which is largely the lower-income brackets, a bit lower than I am talking about, say, $30,000, $35,000. But doesn't evidence show that they go out and make purchases in areas like consumer durables that have a pretty good multiplier?

Mr. ELMENDORF. Well, I think, Senator, that their interest in doing large-scale purchases depends importantly on their expectations going forward. So your statement that under your proposal these would be permanent features would certainly amplify the effects on their large-scale purchases of the sort that you are describing. And, in general, as we have said a number of times and many members of the Committee have said, the uncertainty about what will happen to U.S. fiscal policy, what taxes people will face, what Government programs or benefits might be cut in deficit reduction efforts is a component of the uncertainty that is facing households and firms and deterring their spending. In our assessment, in most people's assessment, the larger source of uncertainty people face is their future incomes before tax, the demand for a firm's products and so on. But the uncertainty about Government policies is important, and the extent to which that can be resolved through any actions of the Congress or reduced uncertainty through actions of the Congress, that would be, we think, a good thing for the economy.

Senator WYDEN. I am glad you mentioned that with respect to the judgment of individuals because I think individuals, much like businesses, are in the general mode of being cautious. They do not know what is going to happen, and they look at yet another proposal that is temporary in nature. I have had people come up to me and say, "Ron, these temporary ideas, what is going to happen is when you all are done with your temporary ideas, everybody will just go back to fighting." And then they see the economy not building a sustained recovery.

So I think the points that you have made today need to ring loudly in this debate about tax reform, and I appreciate your going through this with me, because I think the chance as part of permanent tax reform to, in effect, put off limits from taxation 50 percent of what households make, whether they are making $30,000, $40,000, $50,000, $60,000, $70,000, is a chance to really change behavior in the marketplace because people will see it is not just another temporary proposition. So I think this is very helpful, and I am going to try to get your message to the Super Committee, and with your answers try to highlight this as we go into these last days debating the opportunity for the Super Committee to pass pro-growth tax reform that could kick in with exactly the kind of timetable that you identify in your important report.

Thank you, Mr. Chairman.

Chairman CONRAD. I want to thank the Senator from Oregon. I want to just say publicly that the Senator from Oregon is one of the most constructive members on this Committee and in the body, and I appreciate the really extraordinary amount of work that the Senator has put out on the major controversies and challenges facing the country, whether it is tax policy, whether it is health care policy, whether it is trade policy. It really is quite extraordinary that the Senator who does not have the staff of a Chairman of a Committee has put out very significant plans in a bipartisan way that are really well thought through. I just want to say that the Senator deserves all of our commendation for producing really solid work and big amounts of it.

Senator WYDEN. You are very kind. Thanks.

Chairman CONRAD. Senator Merkley.

Senator MERKLEY. Thank you very much, Mr. Chair, and thank you, Mr. Elmendorf.

I appreciate the work here to analyze the strategies for increasing economic growth and employment. I was looking through to see if there was any specific analysis addressing energy-saving retrofits. I do not believe that it is there. I have a memory of a previous CBO product which looked at various strategies for creating jobs, and my memory is that energy-saving retrofits was at the top of the list, and if I recall right, the analysis went like this: There is not a long time lag that you have for major infrastructure, that the construction industry is flat on its back and ready to be put back to work, that the labor cannot be outsourced so the dollars accrue here in the United States, that virtually all the materials that are necessary for energy-saving retrofits are manufactured in the U.S., so there is extraordinarily low leakage. And I thought all this was analysis that was behind CBO's analysis of this piece of the puzzle.

I did not see that in here. Maybe I am misremembering that CBO had looked at that as a job creation strategy and ranked it very high. Maybe it was some other think tank's proposal. But has CBO looked at that issue?

Mr. ELMENDORF. I am sorry, Senator. I do not remember our having written about that, but I might be mistaken, and we can check to be sure. The factors you have described are important factors in this sort of analysis. Whether the workers are available who need jobs, who can do this sort of work, the extent to which certain sorts of products are imported or not can matter. So the factors you

describe sound like part of a serious economic analysis of the sort that we do, but I do not remember that particular piece, I am afraid.

Senator MERKLEY. Okay. Thank you. And if CBO has not analyzed that, I might request, in whatever fashion is necessary, that CBO take a look at that because certainly we are looking for specific strategies that maximize the bang for the buck in terms of job creation, and I would certainly like to know if that is a strong, cost-effective strategy.

Let me go on to a macroeconomic concern that I have. This is less about things that we can do in the next year or the year after than it is about trends over the last decade and what possibly might happen over the next decade.

What I see happening in Oregon manufacturing is a tremendous amount of jobs going overseas. A piece of this is that, whereas we envisioned that China coming into the WTO would create an opportunity to increase our manufacturing to sell products to a rising middle-class in China, we did not fully anticipate how aggressive China would be in subsidizing their own manufacturing for export that would compete strongly and in some cases undermine American manufacturing, ranging from the pegged currency to the direct grants and subsidized loans to the subsidized utilities, subsidized land, and so forth.

So we have a tremendous number of facilities that have shut down in Oregon and across the country over the last 10 years. It is about 50,000 factories. Combine that with another trend, which is the enhancement in computer-controlled robots, if you will, for building things. I was fascinated to go to a shop that makes knives in Oregon, and in some cases you have people feeding the blades into a machine and flipping them over and re-feeding them. In other cases, you have a mechanical arm bolted to the floor, a computerized arm that is picking up the blade, grinding it in a whole bunch of different ways, dropping it into another bucket, no human involved at all. And as that technology becomes cheaper, it poses a fundamental question, which is: When you have machines that simply increase productivity by a factor of, say, 5, 10 percent and gradual changes, well, then, wages went up. In the post-World War II we experienced this. But when machines start to completely replace the worker, it fundamentally changes whether or not there are jobs that create a living-wage opportunity for American families. So combining the loss of jobs to China and the loss of jobs to not just enhancements to productivity but full replacement of workers poses some fundamental challenges to us in how we have living-wage jobs.

So I wanted to throw that out there and see if—I realize you were doing kind of a more short-term look, but how this might feed into that longer-term concern.

Mr. ELMENDORF. Senator, as you said, in general automation has raised productivity in a way that has greatly enhanced most Americans' standard of living. But it is also true, as you note, that certain sorts of changes can change the distribution of the output in a way that may take it away from some people and give it to others, essentially. And, in fact, the leading explanation that economists offer for the widening of the distribution of wages and in-

comes through much of the income distribution over the past several decades is shifts in technology that have benefitted certain sorts of people and disadvantaged others. There may be separate explanations for the rise in inequality at the very top of the distribution.

But those sort of long-term trends pose a very large challenge for public policy. If you are interested in ensuring that the distribution of the economic pie happens in a certain way, if you are interested in assuring that certain people can make a living even if certain skills they have are no longer demanded by businesses, that is a very difficult problem to address. In addition to the work we do on short-term economic issues, we have work underway trying to address long-term economic challenges as well. Economists talk about education and training. The U.S. spends a rather small share of its GDP on retraining workers relative to many countries in Europe, for example. At the same time, evidence on the effectiveness of particular training programs suggests that not all of them work very well, so it is not a magic bullet. And I do not think that—I certainly do not have—I do not think that the analytic community has a magic bullet to offer you, but that is not to diminish the significance of the trends that you are describing. I think they are significant. And as I say, we have talked about doing more work in education and training, and that is one direction that one could proceed.

Also, of course, one can change tax policy in ways to raise money from certain people or not from others, as you and your colleagues saw fit to do. So there are various levers, but I do not think they are straightforward.

Senator MERKLEY. I have 18 seconds. I would love to see us help working families purchase homes now when the prices are low and when interest rates are at historic lows, helping to absorb this huge surplus of housing we have and to empower a new generation of homeowners. Any thoughts in 1 second? Oops, out of time. But if you are——

Chairman CONRAD. We have been giving everybody some additional time, Senator Merkley, so we can—we have been giving everybody a couple of minutes over the time.

Senator MERKLEY. Thank you, Mr. Chair. Then I would love to hear your thoughts.

Mr. ELMENDORF. You raise another very simple, straightforward issue for me, Senator. In the housing boom, some people ended up being able to borrow money to buy houses that they could not sustain ownership of, that they could not sustain payments on their mortgages. Some of that is because of economic problems and the loss of jobs and loss of income and so on that ensued. But some of that, most analysts think, was just an excessive exuberance in buying houses and borrowing money that was just too much of a stretch for some people.

So I think there is a widespread view that the standards for who will be able to borrow how much money against a house will be tougher going forward than they were during the boom years. At the moment they seem to be tougher even than they were in some years before the boom, and analysts worry about that. And the administration's efforts to work with Fannie Mae and Freddie Mac is

partly to try to ensure that the standards on mortgage lending are not higher now than they were in what looks like a reasonably stable period before the boom.

Beyond that, as you know, the Tax Code provides a considerable incentive for people by subsidizing mortgage interest. Now, there are other policies that you and your colleagues could consider to help homeowners in general or to help potential homeowners in a more targeted way.

Senator MERKLEY. So I will be real quick in my response to allow my colleague to get into his questions, but I do think that I would emphasize less the exuberance factor than the predatory factor. When ordinary working families went to their originator and the originator was being paid undisclosed bonuses or kickbacks to steer them into subprime loans, that was a big problem. When the originator was filling out the loan amount and, if you will, the loan was a liar loan, that was a problem. When there was a prepayment penalty that the homeowner certainly did not understand because they were trusting the mortgage originator, that meant they could not get out of this predatory loan once they had signed into it without paying a huge share of the value of the house—a pound of flesh, if you will—that was a huge problem.

We have ended all those practices. They should not have been allowed in the first place. But I am concerned we are throwing the baby out with the bath water. I would put much of the bubble attributable to the low-cost teaser rates that started in 2003. You can almost track the growth in those loans with the growth of the bubble. And so we do spend about $100 billion a year on interest subsidies. Very little of that goes to working families—very little—indeed, because the standard deduction is higher than the interest cost of an ordinary family buying a home.

So my argument is, in addition to that, shouldn't we be doing matching downpayment grants to enable folks to seize this opportunity, working families to seize this opportunity, whose income does still enable them to buy a house at these lower levels and these lower interest rates rather than having these homes sit empty? My argument would be—and I would love to get additional CBO analysis of it—that that little bit of money, $2 to $3 billion compared to the $100 billion we are spending on mortgage deduction, would be a very valuable investment with a huge set of factors that are reinforcing to our economy in terms of the education of the children, graduation rates from high school, the reduced likelihood of being on public assistance, future in life and so forth. There is a whole series of externalities that come into play with homeowner ship.

Mr. ELMENDORF. I understand the issue, Senator, and we can—I do not think we have analyzed the policy thus far, but we can talk about whether we think we have the tools to do so.

Senator MERKLEY. Thank you.

Chairman CONRAD. Very thoughtful questions, Senator Merkley. That was good.

Senator Coons.

Senator COONS. Thank you, Mr. Chairman. Thank you, Director Elmendorf. I am sorry to have missed your testimony earlier. I was

at an Energy Committee hearing, and I look forward to reading it in full.

I would like to start, if I could, on a topic that we have discussed on the Energy Committee a number of times. In May, Chairman Bingaman and I sent the Congressional Budget Office, sent you, a letter requesting further insight into how CBO views and scores two different instruments: one, energy savings purchase contracts, ESPCs, with which I have some experience from my years in the private sector where I helped manage and implement those, and in the public sector where at the county level we helped utilize those to finance energy efficiency investments at the county government level that I was responsible for; and then, second, longer-term power purchase agreements for Federal installations or facilities as a way to manage some of the long-term costs of deploying a new energy technology, something I think both OMB and the Department of Defense are looking at more closely.

I did get a response, my staff got a response, in July to the first question, so I want to thank you for that, and as I understand it, the CBO continues to view ESPCs as something that have a mandatory expense because, when entered—and OMB, among others, view it as budget neutral, because in the long term contractually it saves the Government money. So this may be an example of something that scores but does not cost, and I would welcome any comment you might have on that.

Then, second, I am still awaiting a response on the power purchase agreements and would welcome any sort of insight you can offer today on that. More than anything, I just wanted to signal a persistent enthusiasm for working with you, it being November, the letter having gone in May, I understand there are many, many other pressing concerns, but I happen to be in a State where we are proceeding apace with deployment of a number of technologies where that might be of some interest or relevance for us, and it is something the Chairman and I have talked about.

Mr. ELMENDORF. So, Senator, I am very sorry that we did not respond to that earlier letter of yours completely. I confess that I did not realize it was an outstanding request, but I will be sure when I go back that we are working on it, and I am sorry that it seems to have fallen through the cracks from our point of view. But we will check and see where that is, what happened.

On the energy saving purchase contracts, I remember knowing a fair bit about this when we returned that letter to you and less about it at the moment. I think there are a couple of issues here. One is how much money is the Government saving on balance, which depends a lot on how the contracts are written. And then the second is the issue you raised, which is how the estimates work. And I think the issue you are referring to is that the contracts themselves count as a cost. The savings can be realized by the Government later to the extent that appropriations actions reduce the funding going to agencies to purchase power. And for longstanding budgetary rules, those things are kept track of separately, but we try in our estimates—there are other cases where this sort of diversion, sort of the pieces, comes up, and we try where we can to offer an assessment of what the savings would be but recognizing that they are reported in somewhat different places. For example, the

PAYGO law refers to mandatory spending, not to discretionary appropriations in the same way. So that is not something that we directly control. It is a feature of the overall architecture of the budget from the Congress' point of view. But we try to provide information on different pieces so people can see the whole picture, and I think we tried to do that in this letter to you about energy savings purchase contracts, but, again, I am sorry. I do not remember the details of it.

Senator COONS. As someone who is in my first year as a Senator relatively new to Federal budgeting rules, I am trying to sort of keep my eye on places where there are, from a broader view, real opportunities for savings but where for budget scoring reasons we do not pursue them. And so if I have in these two instances identified something where I could contribute a more detailed conversation about that, I would be grateful to learn more about it. I am convinced that long-term PPAs have an opportunity to improve both the purchase price for Federal entities of energy and the deployment of new technologies.

Two more questions today, if I might, given time limitations. First, I was struck on the range of cumulative effects of policy options that you laid out today that repatriation scored particularly low, that your analysis in reducing the tax rate on repatriated income showed a very negligible gain in cumulative output. I wondered if a repatriation policy were more tightly articulated with mandatory either hiring policies or infrastructure investment, would you predict any greater impact on the economy or would you continue to score it really at the far low end of potentially beneficial undertakings?

Mr. ELMENDORF. If the policy could be written in a way that it created additional incentive for firms to hire or to invest, then it would have a higher cost-effectiveness performance. What I have not thought about is the extent to which that is feasible to do. So these are the companies that have a lot of earnings overseas and do not get repatriated tend, as we say in our testimony, to have also a lot of assets here in the United States. So they are not in general constrained by not having those funds available, and they can also turn to capital markets in most cases. And they are probably doing some higher investing anyway, so how one would construct the law to link the lower rate on tax repatriation to incremental investment or hiring I am not sure, and we could think about it, and also probably even better would be to talk to our colleagues on the staff of the Joint Committee on Taxation who have much more experience than we do in that sort of issue.

But the reason it gets a low—turns out to have such a low performance by this measure is we think basically the companies would bring the money back, but it does not change their decision whether to hire an extra worker or do an extra piece of investment. If that link could really be forged in a reliable way, that would make the policy more effective.

Senator COONS. There is a bill, which I believe has been introduced, cosponsored by Senators Hagan and McCain, that attempts to do just that, which I have so far not supported in part out of skepticism or concern about that mechanism and its effectiveness. There is another effort underway to use the repatriated increased

tax revenue to the treasury as a way to front-load financing an infrastructure bank, something else I have been looking at. My core concern is: Is there any way, given the fungibility of corporate earnings and profits, to demonstrate in a reasonable way that those repatriated profits are, in fact, deployed meaningfully, which I think is sort of the core criticism of the previous opportunity?

I would appreciate it, if you would not mind—you may have already covered this in some detail—just a quick reference to what you might see as the three most likely to be effective economy-strengthening fiscal policy measures that you think could command bipartisan support.

Mr. ELMENDORF. Senator, I am about the 10,000th most politically knowledgeable person within 5 miles of this building, so I am not the person you want to ask about what is politically viable. All we can do is to offer our analysis of what we think is more or less effective by this measure. And as we have talked about in the written testimony, there are various measures, various criteria by which you and your colleagues can evaluate these policies. But I cannot really apply a filter of political viability for you.

Senator COONS. Then let me ask, if I could, a final question on that, recognizing the difficulty of trying to identify things that could potentially compel bipartisan support. Earlier today Senator Rubio and I announced the introduction of a bill. One of the many features of it is extending expensing provisions for investment costs for small businesses. That also scores, you know, on a very broad range. I may have missed this previous testimony. Is part of the concern about its range of effectiveness the duration or the length or predictability of the period for an extension? In other words, a 1- or 2-year extension of the current accelerated either expensing or depreciation provisions being less effective than a longer-term extension?

Mr. ELMENDORF. It certainly comes—I guess I would emphasize first on the uncertainty, the state of the business cycle and the low rate of utilization of existing capacity. And lowering the cost of investment we think would spur some investment, but how much might be limited by the fact that businesses have capital in hand they are not now using. But it is hard to know how much difference that makes, and analyses of past variations in this sort of provision of the Tax Code have reached some different varying conclusions about how effective the policy has been.

I think this is a case—a sort of policy where short term can actually be better than long term. For many things, one looks to a permanent change in policy as more effective at altering behavior. But in this case, if businesses view this as truly a temporary measure, a sort of sale on buying investment goods for a limited period, that could spur more reaction in the same sense in which a store that has low prices just for this weekend might get people in the door this weekend.

So in that sense, the temporary nature of it can help to accelerate the business investment spending. People who might have thought of doing things next year would do it this year if this provision were in effect. That is complicated by the fact that we have many times in the past, certainly over the last decade, had provisions like this on a number of occasions, so it is less of a—I think

probably viewed less as a one-time thing and more as part of the ever revolving nature of our Tax Code. It also makes it harder for us to judge how businesses will assess its temporariness or permanentness and, thus, how much effect it would have on their investment spending.

So I think the uncertainty we have is not easily addressable through particular changes in the provisions. It just reflects the difficulty of judging how businesses would respond under these circumstances to any sort of proposal like this.

Senator COONS. Thank you. Thank you for your testimony.

Thank you, Mr. Chairman.

Chairman CONRAD. Thank you. Excellent questions. Thank you for your answers, Director Elmendorf.

Just on repatriation, I want to say there is not much of a mystery, I do not believe, because we have done it, and we can now go back and look at what happened. It is very, very clear what happened. The 15 companies that were the biggest repatriators were pharmaceutical, tobacco, technology, and soda companies. Those corporations that accounted for more than half of all the earnings repatriated reduced their U.S. workforce by 21,000 jobs after the tax break that was predicated on them creating more jobs in this economy. What they did do—they did not hire people. They laid off people. What they did do is accelerated stock buy-backs. They increased executive pay 30 percent a year between 2004 and 2006. And, interestingly enough, they accumulated offshore funds at a faster rate than before the tax break.

So I would just say to my colleagues who are kind of intrigued with this idea, corporations that use offshore tax havens get the largest benefit. After the 2004 tax break, a substantial share of the repatriated funds came from tax havens. Boy, is that a surprise.

I tell you, if we get in the habit of repeating these repatriation gimmicks every few years, what incentive does that provide companies? About as clear as it can be, that is a huge incentive to take jobs overseas. Take jobs overseas, safe and secure in the knowledge that Congress will answer the siren song to allow these repatriation holidays, bring the money back at a fraction of the normal tax rate—they are talking as low as 5 percent, 5.25 percent, instead of the statutory rate of 35 percent—and that they will be able to convince Congress, if you would just allow us to do this, it would be one time, only maybe we will do it again in just a few years, and we are going to bring this money back at a fraction of the normal tax rate just in time to lay off some more people and increase executive pay and have some more stock buybacks. My goodness. I mean, fool me once—fool me once, fool me twice, fool me three times. You know, at some point shame on us for buying the siren song.

But, you know, of all the things I have seen—and, by the way, we talk about being worried about the deficit. The Joint Committee on Taxation said it will cost the treasury $79 billion over 10 years. So it adds to the deficit, adds to the debt. The companies that repatriate are very concentrated in tax have countries, and they bring the money back and lay off people. There is a brilliant scheme. Add to the debt, have further job loss, create an additional incentive for companies to move jobs overseas to they can set themselves up for

the next repatriation holiday in which they come back here at a fraction of the normal tax rate. My goodness. I hope we do not fall for that one again.

I thank the Director.

Mr. ELMENDORF. Thank you, Mr. Chairman.

[Whereupon, at 12:00 noon, the Committee was adjourned.]

IMPROVING REGULATORY PERFORMANCE: LESSONS FROM THE UNITED KINGDOM

WEDNESDAY, NOVEMBER 16, 2011

COMMITTEE ON THE BUDGET AND THE
TASK FORCE ON GOVERNMENT PERFORMANCE,
U.S. SENATE,
Washington, DC.

The Committee met, pursuant to notice, at 2:31 p.m., in Room SD–608, Dirksen Senate Office Building, Hon. Mark Warner, Chairman of the Task Force, presiding.

Present: Senators Warner, Whitehouse, Thune, Sessions, and Johnson.

Staff Present: John Righter, Amy Edwards, Ron Storhaug, and Gregory McNeill.

OPENING STATEMENT OF SENATOR WARNER

Senator WARNER. Good afternoon, and I would like to welcome you to a hearing of the Budget Committee's Task Force on Government Performance. Our subject today is "Improving Regulatory Performance: Lessons from the United Kingdom."

Before I get started, I want to thank my Chairman, Chairman Conrad, and Ranking Member Sessions for giving me the opportunity to put together this informal working group over the last couple of years, looking at how we can find some additional efficiencies inside of the Federal Government. Today we are going to be focusing on the regulatory burden, and I am particularly happy that my good friend Senator Ron Johnson is here as well. As Senator Sessions said, this is kind of unusual to have two former business guys chairing a hearing like this.

Senator SESSIONS. You have got a lawyer looking at you.

Senator WARNER. We have a lawyer looking at us. We will not hold that completely against you, but I think there are a great number of lessons that we can learn from the U.K. We will have two sessions today: one from U.K. governmental representatives and then from both business and other folks in the U.K. as well.

As I mentioned, we are very pleased to have two representatives from the British Government as well as two other experts here to share their views on what we in the United States can learn from the British experience to improve our regulatory performance.

This Task Force first discussed regulations at our last hearing when we focused on the implementation of the Government Performance and Results Modernization Act that we enacted last year. Again, I want to thank Senator Sessions for letting that legislation get through at the end of the day, and I think we are yet to see

all the benefits because we have got to make sure we see from our Government agencies both top-performing programs that we have asked in this legislation for the first time ever for least-performing programs, which is, as we all know in Government, a challenge sometimes to identify. That important legislation for the first time included regulatory actions in the agency planning and prioritization process.

As with Government programs, regulations should be monitored and measured to ensure that goals and outcomes are being met. Regulations should be reviewed periodically to ensure that they are still relevant and serving their intended purposes.

Let us start with some of the facts. Regulations are in the headlines every day, with concerns from businesses in particular about the increases in the regulatory burden. I cannot meet a business anywhere in Virginia and I am sure Senator Johnson cannot in Wisconsin or Senator Sessions in Alabama that does not speak about the increased cost on every business of our regulatory environment.

One of the things I wanted to do was to see whether this was a brand-new phenomenon that has happened just recently or whether this is the culmination of historic trends. So over the past year, we have done some research to figure out what is behind these concerns and what we can do to try to put a new balance in place to protect the public interest without overly burdening businesses and the economy.

First, I started by reviewing regulatory trends over time and have we actually seen a huge increase in regulations over the last couple years. And while the perception is that is absolutely the case, at least the data that I have seen does not demonstrate it.

The first chart is actually showing the last 2 years of President Bush and the first 2 years of President Obama's term. According to the GAO, during the last 2 full years of the Bush administration, from January 2007 to January 2009, Federal agencies published 168 major rules. Comparatively, in the first 2 full years of the Obama administration, Federal agencies published 175 major rules. That is not much of a difference.

Now, my colleagues will obviously point out there are a lot of new rules perhaps in the pipeline around financial system and health care, but at least looking at data on data, it has not been as dramatic an increase as some might think.

The next chart shows the number of all final rules from across Government from 1997 to 2010. As you review this trend, you can see ups and downs. This is the actual number of final rules by calendar year, peaking in the late 1990s and actually kind of falling below 3,500 in the last few years. And while both of these charts show that there has not been a dramatic increase in regulations, clearly if we are looking at on average between 3,000 and 4,000 new rules a year, what you have got here is the case of an enormous accumulation of rules and regulations that, quite honestly, we have not—at least in my short time here in the Senate, I do not think we do a very good job of ever going back and culling out what kind of rules and regulations have outlived their time. In fact, we actually do not really know the true costs of regulations on our businesses and the economy.

The cumulative annual costs of U.S. regulatory burden is uncertain. Estimates range from $44 to $62 billion from OMB, but that is maybe a little bit on the low side, and $1.75 trillion from the SBA. That is an enormous difference. If you are talking about $50 billion in annual costs to $1.75 trillion, we have got to do a better job of evaluating what truly is the regulatory burden cost on our economy.

After reviewing our regulatory processes over the past year, I think there are some areas clearly that could be improved.

First, we have got to review existing regulations periodically to remove outdated rules or rules that could be updated to make it easier for businesses to comply. Once added, a regulation is rarely removed or altered. As a matter of fact, I think it was President Reagan who said that the hardest thing to kill is a Government program. What may be even harder than that is a regulation that, once it is ensconced, and, frankly—I think back to my time as Governor—inside agencies, you are actually rewarded with more staff and more personnel if you add more regulations, and there is no incentive to go back and do the hard work of culling out what has outlived its time.

Second, we need to incentivize agencies to reduce regulatory burden while balancing needed public safeguards. Currently several laws already require agencies to review existing regulations periodically, but these reviews in actuality do not happen very often.

Next, we need to improve the integrity of the cost/benefit analysis that agencies produce. We should have some independent review of agencies' findings. I know we are going to be joined in a little while by my colleague Senator Whitehouse, who has introduced legislation this year that calls for more integrity in the agency analysis. And I think this is an important area if we are going to look at regulatory reform, writ large.

And lastly, I think we need to measure the performance of regulations to support ongoing reviews, just like we do with programs. Now, some would argue that we actually do not even do that on a programmatic basis, but we clearly do not do it on a regulatory basis. So I have been working on legislation for over a year to address these concerns that would create a regulatory PAYGO mechanism to incentivize retrospective review of regulations, to make room for higher-priority regulations.

My proposals will include reforms that are similar to some of the policies established in the United Kingdom, and I look forward to hearing from our witnesses and to see what has worked in the U.K. and what has not. And, again, both Mr. Turnock and Mr. Wolff I have had the opportunity to meet with in the past, and I really appreciate them coming back.

Today's witnesses are going to share ideas for us to consider for reforming our process in the United States, and over the past few years, the U.K. has undertaken some substantial reforms to improve their regulatory processes.

On our first panel, we will hear from Mr. Graham Turnock. Mr. Turnock is Chief Executive of the Better Regulation Executive—is Chief Executive of the Better Regulation Executive? Is that the appropriate title? That sounds pretty fancy. He is the Chief Executive of the Better Regulation Executive since March 2011. In that time

he has overseen the introduction of the new One-in, One-out, which I have morphed into regulatory PAYGO, stealing completely from our British friends, this new One-in, One-out policy on regulations and the publication of the first two statements of new regulation. I look forward to Mr. Turnock explaining this.

Members of his team have also been the driving force behind the Red Tape Challenge, a new rolling program to review the stock of U.K. regulation. Previously, he served in the British Department of Treasury and the Department of Trade and Industry, where he was responsible for negotiations with the European Union on a variety of issues.

I would also like to welcome Mr. Johannes Wolff. Mr. Wolff will be available to take questions after Mr. Turnock's statement. Mr. Wolff is the Assistant Director of the regulatory framework's team of Better Regulation Executive. In this role he has led on a variety of projects to develop innovative proposals such as regulatory budgets. Mr. Wolff is currently the lead on the One-in, One-out policy.

With that, I will turn to Senator Johnson and Senator Sessions for any opening statements, and then we will get to our witnesses.

OPENING STATEMENT OF SENATOR JOHNSON

Senator JOHNSON. Thank you, Mr. Chairman. I would like to also thank Senator Conrad for setting up this task force. It is a very important subject. And I would like to thank Senator Sessions, too, for giving up his seat here to give me the head table here.

This is an extremely important subject. I would also like to thank the witnesses for appearing. We are in a pretty dire fiscal situation. I do not have to go over too many numbers. I think today or tomorrow we will probably hit the $15 trillion debt mark. During this administration we will probably add $4 to $5 trillion to our Nation's debt. Our debt will have grown by about 50 percent. And I think from my standpoint—and, hopefully, Senator Warner, you would agree here—that the number one solution in terms of addressing this fiscal situation is economic growth.

As a businessperson, as businesspeople, when you take a look at what it is going to take to achieve economic growth, you have to first of all understand that we are operating in a global economic environment; and it is not whether we have a choice. We do not have the luxury to choose to compete. We simply have to compete. And I think when global investors take a look at the United States, they ask themselves basically three questions on any investment.

First of all, where is growth occurring? Right now it is certainly not in the United States. We are getting growth in China, India, places south of the border in South America. So I guess you would have to consider that strike one.

Then I think any business, any investor would take a look at what is the tax burden. I believe when Japan lowers its tax rate, the United States will have the highest corporate tax rate in the world at 35 percent. I would call that strike two.

Then the third question any business investor would ask is: What is the regulatory environment like? And when you take a look at the regulatory environment in the United States, I would argue it is probably one of the most onerous in the world. That would be strike three.

There are a number of different ways of measuring it, and, Senator Warner, as you pointed out, there is pretty large variation in terms of the dollar amounts. But let me just give you a couple metrics that indicate how big a problem we have got.

If you take a look at the Federal Register, the size of the Federal Register—and I realize this is not a perfect indicator, but back in the FDR administration, the total pages of the Federal Register numbered 80,000. During the Nixon administration, the total pages had grown to 500,000. And currently we are at 3 million.

In just the last 11 years, we have added 41,808 rules and regulations, and we have only developed a cost estimate on 105 of those, 0.25 percent. And I think that may be the disparity in terms of the annual regulatory cost of $20 to $40 billion versus the SBA's estimate at $1.75 trillion.

Now, that is a jaw-dropping number. I think one of the components of that is just the cost complying with our Tax Code. But just for the sake of discussion, let us say it is actually $1.75 trillion. The magnitude of that number is amazing. It is a larger number that all but eight economies in the world. It is 12 percent the size of our economy. And that potentially is the size, the cost of the regulatory burden we are putting on our businesses, our job creators, each and every year.

So this is an extremely important topic. It is something we absolutely need to address. Certainly I commend you in terms of having this task force and your work in this effort. I would love to work with you on this PAYGO system because this sounds like a really good idea.

There are currently 12 bills here in the Senate dealing with regulatory reform. One of them is mine. I have a regulation moratorium, which I think would be a good idea to give us a little breathing space, the REINS Act, make sure that some of these larger, more significant regulations come before Congress for approval before they are enacted. There are 18 bills in the House.

So, again, I would love to work with you on something like this, and I am definitely looking forward to hearing the testimony from the witnesses. Thank you.

Senator WARNER. Senator Sessions.

OPENING STATEMENT OF SENATOR SESSIONS

Senator SESSIONS. No, thank you. Go ahead. I look forward to hearing from the witnesses. Thank you, Mr. Chairman, for having the hearing and for your good work on these and other efforts to make our Government more efficient.

Senator WARNER. Thank you, sir.

Mr. Turnock.

STATEMENT OF GRAHAM TURNOCK, CHIEF EXECUTIVE, BETTER REGULATION EXECUTIVE, UNITED KINGDOM'S DEPARTMENT FOR BUSINESS INNOVATION AND SKILLS, ACCOMPANIED BY JOHANNES WOLFF, ASSISTANT DIRECTOR, BETTER REGULATION EXECUTIVE, UNITED KINGDOM'S DEPARTMENT FOR BUSINESS INNOVATION AND SKILLS

Mr. TURNOCK. Well, good afternoon, members of the Committee, Mr. Chairman, and thank you for giving us this opportunity to testify before this Committee.

As you have introduced me, I will not introduce myself again. I would just like to say that the Better Regulation Executive is part of the Department for Business, Innovation, and Skills, which is clearly focused on growth in the U.K. as its number one priority, and sees regulation as a critical component of growth.

I would just like to say a few introductory remarks about the role of the BRE and about the Government's policies on better regulation, of which One-in, One-out is the flagship policy.

The BRE's role is essentially to set the framework of the U.K. Government's regulatory reform agenda. Reducing unnecessary regulation and cutting red tape is one of its core priorities, as I have said, and Prime Minister Cameron's stated aim is for his Government to be, and I quote, "the first in modern history to leave office having reduced the overall burden of regulation."

Although the U.K. has performed consistently well in the indicators captured by Doing Business—and the Chairman just teased me a little bit about the fact that we dropped to seventh in the world ranking recently—the country's overall rank was in the top 10 of the Doing Business Report in 2011. The new Government believes there is more that can be done to relieve business from burdensome regulation.

The Government has taken a number of steps since coming to power in 2010, and these have included: One-in, One-out; the Red Tape Challenge; Tackling EU legislation, which is an important component of the legislation that business and the U.K. must face; and Regulatory Enforcement.

So if I can cover those briefly in turn, in relation to One-in, One-out, we have introduced the One-in, One-out rule, which focuses on the flow of regulation. One-in, One-out requires Government departments to assess the net cost to business of complying with any proposed regulation, and this is termed as an "IN". These calculations are validated by an independent advisory committee which we established at the end of 2009. This is called the Regulatory Policy Committee, or RPC, and it is charged with providing independent challenge on the evidence and analysis, presented in Impact Assessments, supporting new regulatory proposals. The Committee comprises of six experts on regulation from different backgrounds and scrutinizes Impact Assessments for those proposals from departments. If the Committee provides a negative opinion, or Red, then the proposal is not allowed to proceed.

So to inform business of upcoming regulation and to show progress against One-in, One-out, we publish the Statement of New Regulation. This is published twice a year, and the focus is on domestic regulation, providing an overview of total INs, OUTs, and Zero cost measures. The first Statement of Regulation, or SNR, was

published in April of this year and we recently published the second SNR in September. So far we have seen a significant increase in the number of deregulatory measures, with a majority of departments being able to live within the One-in, One-out rule.

If I can just summarize the position between January and December of 2011, in volume terms we saw 19 INs, or net regulatory proposals; 33 OUTs; and 37 measures which were Zero cost. And I think one additional fact which is useful to add to that is that the number of OUTs increased from 8 in the first 6 months to 25 in the second 6 months; whereas, the number of INs remained roughly constant.

In terms of costs, the INs totaled 338 million, whereas the OUTs totaled 3.4 billion, although I should emphasize that there is a very significant single component in that 3.4 billion number which relates to a regulation which changes the way in which pensions are calculated, and that we expect a balancing regulatory proposal from the same department to largely cancel out that OUT in due course.

So turning to the moratorium on micro businesses, on the 1st of April 2011 the Government also introduced a 3-year moratorium on new domestic regulation affecting micro businesses. These are businesses that have fewer than 10 employees and they account for 50 percent of total employment, as well as genuine start-ups. The exemption is designed to give them breathing space, in the way that Mr. Johnson described, from the constant flow of new domestic regulations and requirements leaving them to get on with doing business.

Any breaches of the moratorium—in exceptional circumstances and only supported by a compelling argument—will require Cabinet-level approval and sign-off by the Economic Affairs Committee, which is chaired by the Chancellor of the Exchequer.

A few words about the Red Tape Challenge. On the 7th of April, we also launched an initiative to scrutinize the stock of regulations. The Red Tape Challenge is a comprehensive thematic review of all regulations affecting business, voluntary organizations, and individuals which aims to identify regulations that could be removed, simplified, or done in a different way. We will publish all regulations in scope of the program on a public website, which is www.redtapechallenge.cabinetoffice.gov.uk, for those who are interested, and we invite the business community and the public to provide practical suggestions for improvement. The process presumes that, if there are no good reasons for retaining them, burdensome regulations will be removed from the statute book.

The purpose of this exercise is to open government up to the public, allowing them to comment on a wide range of regulations which affect them. And to this end, we run a 3-week-long sector campaign so business only needs to respond during those sectors which affect them. So far we have received over 26,000 comments, and 12 themes have been in the spotlight. Following the completion of the first two themes on Retail and Hospitality, Food and Drink, we have announced plans to remove or simplify 220 of the 378 regulations reviewed.

Finally, just a couple of words on both tackling EU legislation and transforming the regulatory environment. We are also taking

steps to reduce the cost to U.K. business from EU legislation. For a start, the One-in, One-out rule reviews any instances of "gold plating." If proposals go beyond the minimum required by the EU legislation, this would count as an IN under the One-in, One-out rule.

This complements our work on engaging earlier in the Brussels policy process, taking strong cross-government negotiating lines, and working to end the so-called gold plating of EU legislation.

Transforming the regulatory Enforcement: Reforming the way in which regulations are enforced is as important as reducing the flow and stock of regulations. We are working, therefore, with regulators to end the tick-box approach to regulation, seeking out the best way of securing effective compliance without creating unintended consequences. Business groups have given us the clear message that they want to see a culture change amongst regulators, with a greater understanding of how business actually operates and a more consistent approach to enforcement so that compliant businesses do not lose out at the expense of rogue businesses.

We have already started to reform some of the most disproportionate enforcement systems and have commissioned a number of independent external reviews to examine specific areas in detail. An example of this is Lord Young's review of how health and safety law is implemented and on ways for Government, regulators, and business to reduce heavy-handed enforcement of regulation in the agriculture and food-processing sectors.

In conclusion, tackling the regulatory burden is at the top of the Government's agenda. The system we have introduced is designed to free the potential of U.K. business to concentrate on growing their business, creating jobs, and driving forward our economic recovery.

In essence, our work is about ensuring policymakers think more creatively about whether the traditional "command and control" approaches to regulation—and many of its sometimes unintended consequences—is the most effective way to achieve desired policy outcomes. Against the backdrop of a rapidly changing global economy, we are asking colleagues whether a combination of various non-regulatory policy instruments can be more effective in achieving a particular policy objective at lower cost and with lower levels of coercion.

Thank you.

[The prepared statement of Mr. Turnock follows:]

United Kingdom: Regulatory Framework

Introduction

Thank you for inviting me to testify this afternoon.

My name is Graham Turnock and I am the Chief Executive Officer of the Better Regulation Executive – or BRE as we know it – which is part of the Department for Business, Innovation and Skills.

The BRE's role is essentially to set the framework of the UK Government's regulatory reform agenda. Reducing unnecessary regulation and cutting red tape is one of its core priorities and Prime Minister Cameron's stated aim is for his Government to be, and I quote, "the first in modern history to leave office having reduced the overall burden of regulation".

Although the UK has performed consistently well in the indicators captured by *Doing Business* — the country's overall rank was in the top 10 of the *Doing Business Report 2011* — the new Government believes there is more that can be done to relieve business from burdensome regulation.

The Government has taken a number of steps since coming to power early in 2010. These have included:

- One-in, One-out;
- The Red Tape Challenge;
- Tackling EU legislation;
- Regulatory Enforcement;

One-in, One-out

We have introduced the One-in, One-out rule, which focuses on the flow of regulation. One-in, One-out requires Government departments to assess the net cost to business of complying with any proposed regulation ('termed as an 'IN'). These calculations are validated by an independent advisory committee which we established at the end of 2009 – this is the Regulatory Policy Committee, or RPC – and it is charged with providing independent challenge on the evidence and analysis, presented in Impact Assessment, supporting new regulatory proposals. The Committee consists of six experts on regulation from different backgrounds and scrutinises Impact Assessments for these proposals from departments. If the Committee provides a negative opinion, or Red – then the proposal is not allowed to proceed.

To inform business of upcoming regulation and to show progress against the One-in, One-out rule, we publish the *Statement of New Regulation.* Published twice a year, the focus is on domestic regulation, providing an overview of total Ins, Outs, and Zero cost measures. The first Statement of Regulation, or SNR – was published in April of this year and we recently published the second SNR in September. So far we have seen a significant increase in the number of deregulatory measures, with a majority of departments being able to live within the One-in, One-out rule.

Position: January to December 2011	
Volume	
INs	19
OUTs	33
Zero net cost	37
Annual regulatory cost to business (millions)	
INs	£338.35
OUTs	-£3,381.63
Net	**-£3,243.28**

Moratorium on micro-businesses

On 1 April 2011 the Government also introduced a three-year moratorium on new domestic regulation affecting micro-businesses – these have fewer than 10 employees and account for 50% of total employment – as well as genuine start-ups. The exemption is designed to give them breathing space from the constant flow of new domestic regulations and requirements leaving them to get on with doing business.

Any breaches of the moratorium – in exceptional circumstances and only supported by a compelling argument – will require Cabinet-level approval and sign-off by the Economic Affairs Committee, chaired by the Chancellor of the Exchequer.

The Red Tape Challenge

On 7 April, we also launched an initiative to scrutinise the stock of regulations. The Red Tape Challenge is a comprehensive thematic review of all regulations affecting business, voluntary organizations and individuals which aims to identify regulations that could be removed, simplified or done in a different way. We will publish all regulations in scope of the programme on a public website (www.redtapechallenge.cabinetoffice.gov.uk), and invite the business community and the public to provide practical suggestions for improvement. The process presumes that, if there are no good reasons for retaining them, burdensome regulations will be removed from the statute book.

The purpose of this exercise is to open government up to the public, allowing them to comment on a wide range of regulations which affect them. To this end, we run three week-long sector campaigns so business only needs to respond during their sectors. So far we have received over 26,000 comments and 12 themes have been in the spotlight. Following the completion of

the first two themes, Retail and Hospitality, Food and Drink, we have announced plans to remove or simplify 220 of the 378 regulations reviewed.

Tackling EU legislation

We are also taking steps to reduce the cost to UK business from EU legislation. For a start, the One-in, One-out rule reviews any instances of 'gold-plating' – if proposals go beyond the minimum required by the EU legislation, this would count as an In under the One-in, One-out rule.

This complements our work on engaging earlier in the Brussels policy process, taking strong cross-Government negotiating lines; and working to end so-called 'gold-plating of EU legislation so that when European rules are transposed into UK law it is done without putting UK-based business at a competitive disadvantage to companies in other EU Member States.

Transforming Regulatory Enforcement

Reforming the way in which regulations are enforced is as important as reducing the flow and stock of regulations. We are working with regulators to end the tick-box approach to regulation, seeking out the best way of securing effective compliance without creating unintended consequences. Business groups have given us the clear message that they want to see a culture change amongst regulators, with greater understanding of how business operates, and a more consistent approach to enforcement so that compliant business do not lose out at the expense of rogue business.

We have already started to reform some of the most disproportionate enforcement systems and have commissioned a number of independent external reviews to examine specific areas in detail. An example is Lord Young's reform on how health and safety law is implemented and

on ways for Government, regulators and business to reduce heavy-handed enforcement of regulation in the agriculture and food-processing sectors.

Conclusion

Tackling the regulatory burden is at the top of the Government's agenda. The system we have introduced is designed to free the potential of UK business to concentrate on growing their business, creating jobs and driving forward our economic recovery.

In essence, our work is about ensuring policy-makers think more creatively about whether the traditional 'command and control' approach to regulation (and many of its sometimes unintended consequences) is the most effective way to achieve desired policy outcomes. Against the backdrop of a rapidly changing global economy, we are asking colleagues whether a combination of various non-regulatory policy instruments can be more effective in achieving a particular policy objective at lower cost and with lower levels of coercion.

Better Regulation Executive
Department for Business, Innovation & Skills, UK

November 2011

Senator WARNER. Thank you, Mr. Turnock.

Let me just again—I have spent more time than my colleagues with this. Could you take a moment and re-explain a little bit the concept between One-in and One-out? Because my sense had been at one point that this was—as a new regulation was proposed and the benefits—and I want to come to the benefits piece of this. I would like you to explain that as well because every regulation is supposed to have some benefits as well as costs.

If it nets out on the cost side, it counts on the IN category, and that dollar then has to be matched against something that comes out on the OUT category. Is that trued up on an annual basis, on a multi-year basis? And how did you get that right? How did you get that balancing right?

Mr. TURNOCK. Yes, just to go through a little bit more of the actual mechanics of the process, if I am a department seeking to introduce a new regulation, then I have to calculate the impact of that regulation, and that is done in a document that we call an Impact Assessment, which is published at the time that we go out to consultation on the document. So that is a bit like your notice and comment process.

That document does two things. It calculates the global benefits and costs of a regulation, which would always expect to be positive. But it also calculates a metric which is specific to One-in, One-out, which is the net direct impact on business. So what that looks at is the direct costs to businesses affected by the regulation and then any offsetting direct benefits to businesses of those regulations.

Now, the reason we are doing this is because we are applying an affordability to business test on all regulation. The reason for that is relatively simply that effectively most regulation is net beneficial to sectors other than business at a net cost to business. So it is a form of, you could say, taxation on business. But to date, there has been no budget for that taxation. So, effectively, One-in, One-out is a form of regulatory budgeting, but we are setting the budget at zero so that any new net cost to business has to be balanced out by a net saving to business. So returning——

Senator WARNER. And then—I am sorry.

Mr. TURNOCK. So returning to the process.

Senator WARNER. And then when do you have to true this up? Because you said you had 33 OUTs, a certain number of INs.

Mr. TURNOCK. Exactly. So the theory is that whenever a department comes forward with a new regulation, it has to say at the same time where it is finding the savings to true that up from. So it might say we are bringing in a regulation that increases the reporting requirements on businesses in a particular sector, and we are reducing the reporting requirements on another sector.

Senator WARNER. And is that done within that one agency? You cannot transfer it from health care over here to aviation over here? It is done within a specific agency, correct?

Mr. TURNOCK. In the first instance, all agencies are expected to balance up or true up themselves. There is provision if an agency can make a demonstrably good case that it cannot balance up itself for balancing across Government, but we have not got to that point yet because we are expecting all agencies to manage to balance up

themselves at this stage. But the methodology sets that out as a possibility.

So the agency has to come forward to a ministerial committee and convince that committee that it has got plans in place or in development that will enable it to balance the impact to the regulation that it is bringing in.

However, there is a secondary check on the process, which is these 6-month statements of new regulation. So we have a system where we seek to bring as much new regulation in as possible on a common commencement date so that business know when in the year the regulatory system will change, and that is roughly at the beginning of April and the beginning of September.

So this provides a final opportunity for us to look across Government at each agency and say: "Now that we know which regulations you are actually going to bring into force in April or October, we want to check that you are still in balance. We thought you were in balance, because when you came to us earlier in the year you promised that you were going to bring in this deregulatory measure to balance out this regulatory measure. Now that we have got to the last point of which the regulations are now going to go live, we want to check that you are delivering on that promise."

The ministerial committee that reviews the position at that point is empowered to stop agencies statement from going ahead with regulation at that point.

Senator WARNER. I want to make sure my colleagues get a chance. Two points that I found interesting. One is that your RPC ends up becoming that more neutral arbiter—correct?—of what the cost and benefit is. One of the challenges, I think, that we have in our Government is that you do not know who to trust in terms of what the costs and benefits are. You have an industry that might have a cost way up here. You might have a public interest group that says the benefit is way up here. There is no neutral arbiter.

One of the things that we have looked at—and I am not sure this would be the right approach because one of my concerns with the REINS Act is putting Congress in more things actually scares me.

Senator JOHNSON. Me, too.

Senator WARNER. But, you know, the notion of whether a CBO might be able to have—or some other entity independent of an administration might be that independent arbiter, because you do have to have a measure of both the costs and benefits.

I will leave for the second round the question, though, that there were—they did not start with this the whole Government. They had a series of exclusions. If you could touch on that briefly, and then we will go to Senator Johnson and Senator Sessions.

Mr. TURNOCK. Certainly we have listed comprehensively the exclusions to the One-in, One-out, and there are 15 of them. Some of them are really just for the avoidance of doubt, so for example, fees and charges which are set out in regulations or statutory instruments, which simply enable agencies to recover the costs of certain services, are excluded.

We are also really interested in influencing the behavior of government departments. So where there is effectively no real choice in bringing in a new regulation, we do not include that in the One-in, One-out methodology. So that covers, for example, situations

such as civil emergencies and contingencies where emergency legislation needs to be brought in. An example might be, although this is probably covered by European legislation, foot and mouth, for example. Animal health would be an emergency situation.

We are also not including situations where a judicial process may have ended up changing the way in which a regulation is imposed because, again, that is out of the control of the agency.

One of the biggest areas of exclusion is European community policy, because again, that is decided in Brussels and it is a case then of transposing that legislation into domestic regulations. However, we do make one key caveat to that, which is that if the agency goes further than is required by that Brussels legislation, then that scores against that One-in, One-out category.

And then a final big area of exclusion is tax and financial stability. Tax, because we have set up a separate process under an Office of Tax Simplification on Financial Stability because that is an area which has as we see global significance at the moment and where we believe that there needs to be net increase in regulation realistically to address systemic financial failure.

Senator WARNER. I guess I would like to call on my colleagues, but just, they did, as we get into the second panel, this has been an ongoing process. They have started to phase in this approach rather than trying to take the whole government at once in terms of changing the regulatory framework? They did phase it in and I think they have got some very interesting results. Senator Johnson.

Senator JOHNSON. Well, Senator Warner, I share your same concern about getting Congress involved in more things. But I also am concerned about setting up a new agency. So let us talk a little bit about this RPC. How large is it? You said there are six experts on the panel. Has this bureaucracy grown?

Mr. TURNOCK. Actually, I think, overall, the introduction of the One-in, One-out rule has enabled us to reduce the total number of people doing this in the center. We had getting on for 100 people in the Better Regulation Executive around about a year ago, so we are probably the equivalent of OIRA in the U.K.

And because we did not have this kind of leverage over departments to get them to do a better job of regulation, we were involved in very detailed discussions on a range of policies really trying to sort of balance out the natural tendency to regulate more.

With the establishment of this new regulatory policy committee which has 12 members of the secretariat, we have managed to reduce the total numbers from around about 100 to 60. So 12 people have gone into this new secretariat, and the core Better Regulation Executive is down to below 50 people now.

Senator JOHNSON. So this did not set up a new agency. It actually took an agency and it has actually shrunk it?

Mr. TURNOCK. Yes, that is right.

Senator JOHNSON. Yikes. Good job. Are there any limits in terms of what regulations they are taking a look at, or is every new rule and regulation having to go through the same process?

Mr. TURNOCK. We have not set any low or dual eligible minimis thresholds at this stage. One reason is that we really want to get a culture change in the regulatory agencies and departments. And

so we think that it is important that every rule goes through the same process and is subject to scrutiny.

But obviously, by its nature, the big ticket items will get greater focus because they are going to have a bigger impact on each department's balance, so they will get a greater focus from departmental officials. They would probably get the same focus from the secretariat and the RPC because they are looking at the quality of the analysis. But I would guess when it comes to our scrutiny from an overall perspective, we give greater scrutiny to the bigger measures as well.

Senator JOHNSON. You mentioned cultural change. That is actually one of my questions. I will hop right to it. You mentioned that the outs went from 8 to 25. Are you starting to see a culture change? Are people in the regulatory agencies actually now starting to focus or are they possibly incentivized for finding regulations that they can eliminate?

Mr. TURNOCK. Well, I think we are seeing more effort to find regulatory outs and that has been helped by the red tag challenge which has been led at a very senior level within the government and the civil service with a lot of encouragement to civil servants to just push the margins out a little bit and put the choices up to ministers rather than what we kind of are concerned may have happened in the past, that at relatively junior operational levels, decisions actually end up getting made which are quite risk averse and then they become cumulative within the system.

So we are seeing, I think, the beginnings of a culture change where civil servants see it as a badge of honor that they have reviewed an area and been able to deregulate and reduce costs on business. We are also seeing, I think, much less immediate assumption that regulation is the best way to address policy problems simply because departments are finding it much harder to get new regulations through the system.

So they are incentivized to look at alternatives to regulation. But we are only about, well, 9 to 12 months through the process, so I think any culture change process needs quite a bit longer than that to take full root.

Senator JOHNSON. Have you considered or are you paying any rewards or incentives for coming up with these ideas?

Mr. TURNOCK. Yes, absolutely. I mean, in the U.K.—I do not know about here—we tend to do things in a relatively low key way, but we have something that we call the Civil Service Awards which are sponsored by the Cabinet Secretary, and we have introduced the category which is for a better regulation approach. And we had an alternative to regulation around the responsibility deal in the health sector that won that.

And also—well, actually, I should say they were short-listed. The final awards have not been announced yet. And also, we have a short-listed member of one of our change agent teams within one of the agencies who has been nominated for the Civil Service Leadership Award, which we are really excited about.

Senator JOHNSON. So it is a competition type of award as opposed to you bring us a good regulation and you get 1 percent or that type of thing?

Mr. TURNOCK. Yes. I think that was sort of talked about in a fairly humorous way, but in practice, monetary compensation is not really an option in a big way at the moment.

Senator JOHNSON. Okay. I understand that. Have you considered, you know, one-for-one is great. Have you considered going to maybe two-to-one, three-to-one? Would that be possibly something in the future?

Mr. TURNOCK. It is definitely something that you could do within the system, so the system is set up to allow a change in the exchange rate. It is something that ministers might want to consider if they felt that actually the first fruits of the process were very encouraging and that they wanted to drive the system harder to look for more deregulatory measures. At this stage, they are not asking us to do it, but they may wish to consider those options.

Senator JOHNSON. Okay, thank you.

Senator WARNER. Senator Sessions.

Senator SESSIONS. Thank you very much. I appreciate your insight, and the U.K. frequently leads the United States in reforms, and so I am inclined to believe reform and regulation is important and we thank you for your leadership and sharing your insight.

Part of the American economy is the Government itself. There are regulations within the Government that require governmental employees to do things that have no reach outside the Government, but become established over years that have no real value and actually cost efficiency. Does your plan deal with any of that, to allow the agencies themselves to eliminate rules that need to be eliminated?

Mr. WOLFF. Technically we have processes in place where we could do that, so I think the process allows us to change the currency, as Mr. Turnock said. We only capture business costs right now, so we do not actually look at any burden that is placed on the public sector. But it is conceivable that the system could be changed to look at that as well.

Senator SESSIONS. I was a Federal prosecutor and had an office up to 50 people, but Federal regulations sometimes made it difficult for me to do my job and provided little benefit. Also, we required, over the years, a huge number of reports to the Defense Department. Every time something came up—and they would do this every year for decades long after the value of those reports were necessary, so sometimes Congress is directly responsible for the problem.

Mr. Turnock, one of your goals, maybe your number one goal, is to help your economic sector be more productive and more competitive. Are you confident that eliminating regulations that lack value helps reduce costs, save money, and make your businesses more competitive?

Mr. TURNOCK. Well, I think absolutely. If we are removing regulations which have gone past their "sell-by date," such that they are no longer really delivering any benefit but are still imposing costs, or if we can reform regulations so that they can achieve the same benefit but at lower cost, then we must be doing the economy some good.

Now, obviously, there are always second and third effects and there is quite a large industry of consultants that has built up

around some of the regulatory regimes, but I think it would be reasonable to say that if we are removing fundamentally unproductive activity from the economy, then the overall benefit must be positive.

Senator SESSIONS. And if a company made widgets and regulations were imposed on that manufacturer, the number—and employees were now necessary for the widget company to comply with the regulations, if the regulation is of no benefit or limited benefit, that employment really should not be counted, should it, as a benefit to the economy, and the consultants that sometimes help companies reach those goals.

Mr. TURNOCK. I think if you want to, you can make analyses that suggest that a regulation or a particular regulation is good for jobs, but I think we would start from the presumption that actually what we want is strong growth in the economy. We want high value jobs so we want businesses that could invest in the skills in their employees.

We want a government which has a good tax take because the economy is doing well and therefore could invest in skills and education and universities. Therefore, what we want is a regulatory environment which encourages growth and that is generally considered to be a regulatory environment that does not impose unnecessary costs and which does not create significant uncertainty for business when it is thinking about either taking on people as additional employees or significant investments. So I think that would be the general philosophy of the government in relation to how better regulations support jobs.

Senator SESSIONS. In an economic sense, a fundamental principle needs to be understood, I believe, and that is there is not difference in an economic sense between the Government taxing the American people and going and changing the way an energy, electricity-generating plant is operated than passing a law that requires that company to do the same thing, is it?

Mr. TURNOCK. I think you are right. I mean, I think one of the problems with regulation is that it is a bit of a free good, so budgetary expenditure is very difficult to obtain. It requires the support of the legislature and it is always limited, and in the past, regulatory measures have been at the cost often of business, but also others, and they have not been budgeted, so One-in, One-out is effectively a way of budgeting and limiting those costs and forcing a more active trade off between different policy instruments.

Senator SESSIONS. I think sometimes we in Congress want to do something that we would like to accomplish. We do not want to tax our constituents to pay for it, so we just pass a law to make someone else do it and it does not score. It is not a cost, but it is a cost to the economy if it is not a smart requirement, if it is a burdensome requirement.

I would just note that we do have a disagreement around here. Just a couple of days ago, our friend and colleague, Senator Reid, the Democratic leader, said this: My Republican friends have yet to produce a single shred of evidence that the regulations they hate so much do the broad economic harms they claim. That is because there is not any. I guess he means there is not any harm. But Re-

publicans are not relying on evidence as they propagate the myth of job-killing regulation, they are relying on repetition.

While I do think there are good regulations and bad regulations and we need to honestly evaluate what is productive and beneficial and honestly eliminate those that are not, and I certainly think there is evidence to show and will continue to come forth to show that we have many regulations that are not beneficial, but are actually costly and return no value or little value.

Thank you for your leadership, Mr. Chairman, and you are doing the hard work, the detail work that will be necessary for legislation to move forward that could actually begin to improve our situation.

Senator WARNER. Thank you, Senator Sessions. Let me just—and I know that spirits in our sessions have said that. I mean, nobody wants to climb on an airplane that has not been inspected or eat a food product that is unsafe. So there has to be a benefit side on some of this.

One of the things that I thought was interesting in some of my previous conversations was—correct me if I am wrong—that a lot of the value of this process did not really come on straight the ins and the outs, but the sense that the agency would have to, if they had an in, pay for it with an out, meant that as they devise the in or as they devise the regulation, that was in their mind set.

So if there is a way they could get 85 percent of the benefit for 20 percent of the cost versus 95 percent of the benefit for 100 percent of the cost, that there would be that weighing. You do not want to do it in a way that jeopardizes public interest, but that internal calculus inside the agency was something that took effect that is hard to sometimes quantify. Do you want to comment on that, Mr. Turnock?

Mr. TURNOCK. Yes, I think that is absolutely right. What we want is a full analysis of the options at an early stage, which takes into account the cost on business, and as you say, this has the merit of internalizing that cost by making it much more transparent to the agency, and therefore, it should drive the agency to think about options that reduce the cost on business.

You are right, at the margin, that might mean a small sacrifice of some of the benefits, but one has to take both the costs and the benefits into account and give it, in your example, the cost-benefit ratio would be much better in the 85/20 example than the 95/100 percent example.

Now, obviously, traditional cost-benefit analysis ought to point to that as the right conclusion anyway, but we think that One-in, One-out is an additional, very helpful pressure in the right direction.

Senator SESSIONS. Just to follow, and I do think that regulations pass sometimes to identify a specific problem, but it applies to far more industries than have that problem and they are required to follow a regulation that is really no benefit, although it may benefit if it is targeted to a more narrow focus there.

But I guess that would score in your process, too. You would still have the advantage of reducing the cost by targeting just the area that needs the regulation.

Mr. TURNOCK. Yes. Although I should emphasize that in all of this, we are really looking for agencies, also, to look at non-regu-

latory approaches through, perhaps, industry schemes, voluntary arrangements, and pairing consumers, various other approaches which do not require regulation which places a large cost and compliance burden on businesses which are already doing the right thing, just to catch a small minority of businesses that we want to bring in line somehow. So I think there is a fundamental desire to try and move away from regulatory approaches where possible.

Senator WARNER. I have just got one other quick question. One of the things that you sometimes hear, and I do believe there is clearly value in regulations where you have got to have them appropriate and the benefit side, as we mentioned earlier, that is looked at a little bit of the RPC, but this is more focused on the business.

One of the critiques we hear at times is that businesses will point out that there is lots of regulatory burdens, but then when they are actually asked to identify specifically what are those old rules or regulations that are outdated, at least in this country, the lists that have come forward have been rather meek.

It sounds like in your Red Tape analysis, by kind of pushing the edge on this, it may not mean elimination of some of these rules and regulations, but it might mean less reporting or it might be cleaner reporting or more efficient reporting. Could you speak to that for a moment?

Mr. TURNOCK. I think sometimes if you just phrase the question, Do you want to get rid of it or do you want to keep it, you have polarized the debate perhaps a little bit too much. There will be different views amongst different businesses in a sector. Some businesses might find a regulation less burdensome and they might be attracted to some of the benefits that they receive from it and others might not be.

So I think some of the time we have the same issue that you have with business representative groups. They find it difficult to find a consensus amongst their members and therefore, they are somewhat reluctant to point out specific regulations that they would like to see removed even where objectively were all the analysis done, it would be beneficial to business to remove those regulations.

The desire for consensus is a strong factor in preservation of the status quo. So that definitely is an issue, but we have made some good progress with business groups recently on pinpointing and guiding them towards the areas that we would like their views on, and I think Red Tape Challenge has been a useful factor.

Senator WARNER. I would love to see—you said you have looked at hospitality and food services. To some level of specificity, it would just be interesting. Senator Johnson, do you have anything?

Senator JOHNSON. Sure. I would just like to get some basic pieces of information. You saw the charts that we were using up here that we were displaying. We are issuing three to four thousand rules and regulations each year. Do you have a similar metric in the U.K.?

Mr. WOLFF. I think it is difficult to really get on top of some of the metrics. I think we do see around 2,000, 3,000, 4,000 pieces of legislation coming through, but then identifying which ones are relevant for our agenda in the sense that there are a number of small

items like road closure orders, for example, and they are a regulation technically, but they do not really have much of an impact.

So in terms of the regulations that we consider have a major impact on business, we are talking about roughly 80 to 100 or 120 annually, which is roughly what we can cut through under the One-in, One-out rule. So it is, depending on how you define the burden and who is being captured, you really need to be careful about how that is all looking. So, you know, there are just different ways of measuring it, number of regulation pages, costs, volume, et cetera.

Senator JOHNSON. Sure. Do you have any estimate? Has there been a study conducted that lays out the estimated cost of annual compliance in the U.K. with a regulation?

Mr. WOLFF. We did have an essentially baseline measurement exercise about administrative burdens in the mid-2000s. When it came to the One-in, One-out rule, we decided that another baseline measurement was not necessary, essentially because the One-in, One-out does not require one. For every new pound you bring in, you take a pound out. There have been various estimates, private sector, the British Chamber of Commerce for example has undertaken an estimate of the cumulative burden. One-in, One-out is designed to really cap it.

Senator JOHNSON. What was that cumulative burden?

Mr. WOLFF. We are in the several billions. It varied and there were different reasons why we kind of—we are on board with the number. But what One-in, One-out was trying to do, or it does do, it really caps the additional burden of corning in and it really brings the numbers out into the open. And trying to get on top of the cumulative burden, you could say, Well, we want to reduce it by 25 percent. But going out and trying to really calculate that all seems like a huge undertaking which One-in, One-out does not require.

Senator JOHNSON. Let me just ask just the general perception of the British business people, you know, the European businesses in terms of the regulatory burden here in the United States. I mean, when your businesses look at the U.S., is it an attractive place for business investment?

Mr. TURNOCK. Well, I am not sure I am really the best person to try and answer that question, but I would just point to the fact that you do very well in the LEAP [phonetic] tables that we were just discussing earlier. So it cannot be that bad. But equally, I am sure there is room for all of us to do better.

Senator JOHNSON. In the U.K., do your businesses have governmental affairs offices? Do they have compliance, regulatory compliance officers for the businesses? Is that pretty common?

Mr. TURNOCK. Yes, I would say that is pretty common. I mean, certainly the bigger businesses would have that kind of unit. Noncompliance could be very expensive for them if they had to close down facilities, for example, in a sense, some of the problems of smaller businesses that cannot afford to have that kind of unit or that dedicated expertise on the staff.

Senator JOHNSON. Okay. Well, appreciate that. I have to leave here quickly, but I just got handed two pieces of information. First

of all, the Treasury just announced that we hit $15 trillion in debt, gross debt. That is not exactly a banner statistic.

Senator WARNER. All the more reason for Simpson-Bowles Gang of Six.

Senator JOHNSON. I guess to show a little evidence that maybe regulations do cost businesses something, a recent survey by Wells Fargo of small businesses said that 22 percent responded that the number one problem facing them was complying with government regulations. So I guess that just refutes what your leader was saying on the floor the other day.

But with that, again, thank you very much for holding this hearing and thank you. This was very informative. This is something that I would like to work with you on. This is a really good idea. Thank you.

Senator WARNER. Thank you, Senator Johnson. Mr. Turnock, Mr. Wolff, thank you very, very much. I know a long voyage. I appreciate you coming over.

We now are going to have a second panel and we very much invite you to—I do not know what your schedule allows, but would love to have you stay if you can. But thank you both, gentlemen.

I would now like to go ahead and welcome our witnesses for our second panel. We have two distinguished experts to share their perspectives about what the U.S. could learn from British lessons on regulatory reform. Today we will hear from Dr. Michael Greenstone and Mr. Jitinder Kohli.

Dr. Michael Greenstone is the 3M Professor of Environmental Economics in the Department of Economics at MIT and he is on the MIT Energy Initiatives Energy Council and on MIT's Environmental Research Council.

In addition, he is a Senior Fellow at the Brookings Institute and a research associate at the National Bureau of Economic Research. Dr. Greenstone has also served as the Chief Economist for President Obama's Council on Economic Advisors for the first year of his Administration.

We will also hear from someone I have had the opportunity to get to know over the last year plus, Jitinder Kohli. He is a Senior Fellow at the Center for American Progress where his work focused on government efficiency, regulatory reform, and economic issues.

Prior to joining CAP, he spent 15 years in British government between 2005 and 2009. He was the first Chief Executive of the Better Regulation Executive where he was responsible for regulatory reform for the U.K.

He has also had a major program to reduce the administrative burden of regulations by 25 percent over five years and to change the culture of regulators so they focused on efforts on areas of greater risk. Thank you both for being here and we will begin with Dr. Greenstone and then Mr. Kohli.

STATEMENT OF MICHAEL GREENSTONE, 3M PROFESSOR OF ENVIRONMENTAL ECONOMICS, DEPARTMENT OF ECONOMICS, MASSACHUSETTS INSTITUTE OF TECHNOLOGY

Mr. GREENSTONE. Thank you, Chairman Warner and members of the Task Force on Government Performance, for inviting me to speak today. I appreciate the opportunity to speak to you today

about the Government's system of regulatory review. It is essential that our regulatory structure protects the well-being of our citizens without imposing unnecessary costs on American businesses and society as a whole.

But in making decisions about regulations, public officials must choose which areas of our lives merit Government rules as well as how stringent those rules should be. And so I thought I would talk a little bit about an example, a classic example, the Clean Air Act, which is a piece of regulation—legislation that has produced regulations that have a series of benefits and costs.

Before its passage in 1970, there were few constraints on businesses that emitted pollution as a byproduct of their operations, and the result was predictable. There was very poor air quality. As one example, it was common for white-collar workers in Gary, Indiana, to bring an extra shirt to work because the first one would be dirty from the air and unfit for wear by the middle of the day. But even more importantly, some of my research, as well as research by others, has found that the polluted air led to elevated mortality rates that reduced the life spans of the American people. And, obviously, no business sets out to cause these impacts, but in trying to maximize their profits, it was not in their interest to install expensive pollution abatement equipment when their competitors did not have to do that. So as a result, they did not act to adequately reduce emissions.

At the same time, the Clean Air Act's regulations cause firms to alter their production processes in ways that raise their costs. Drawing on some of my other research, I found that an important set of rules that are embedded in the Clean Air Act or as a consequence of the Clean Air Act have raised polluting industries' production costs by about 2.5 percent. The result of that is that their profits are lower, the prices for the goods they sell are higher, and the prices for the consumers are higher. It has even led some of those firms to scale back their operations and reduce employment, and I should emphasize reduce employment in those industries.

Ultimately, the number of jobs in the economy is largely unaffected by regulations, but one should not ignore that the workers who lose their jobs in particular industries often face prolonged periods of unemployment and re-employment at lower wages.

So the challenge for regulators is to set rules with benefits that exceed their costs. This seems incredibly basic, but a weakness in our regulatory system is that we do not generally have the information necessary to make these judgments, and this is because the approach that we have generally used to regulation is to evaluate those regulations' likely benefits and their likely costs before they are enacted. However, this is the very point when we know the absolute least because they have never been enacted before. And so the weakness is that once a regulation is implemented, it often goes on the books and can stay their for years, even decades, without ever finding out did it work the way we thought it would.

President Obama's recent regulatory reform proposal, spelled out in Executive Order 13563, is an important step in the right direction.

In the remainder of my testimony, I am going to try to identify some ways to extend this reform so that our regulatory system consistently produces rules with benefits that exceed costs.

With respect to Executive Order 13563, I think there are three reforms that build on that that could make our regulatory system more effective.

The first is I recommend institutionalizing the retrospective review of economically significant rules in a public way so that these reviews are automatic. In the case of rules that are currently in force, this would mean publicly committing to a retrospective analysis within a pre-specified time period. This might be 5 years; it could be 10 years. It kind of depends. It would depend on the length—it would depend on the particulars of the rule and the results of any previous reviews.

In the case of new rules, the implementing agency would be required to announce a timetable for review with a maximum allowable amount of time, say 5 or 10 years. Obviously, shorter time periods would be preferable.

In addition, the agency would be required to pre-specify where they expect the benefits and the costs to emerge so that the terms of the subsequent review would be known in advance. The agency would also be required to identify how several years later these benefits and costs would be measured; this might include specifying the types of data and other information that it anticipates being necessary for review.

The second way to extend the President's Executive order in a meaningful way is that agencies should commit to undertaking new rulemakings when the results from these retrospective reviews differ from the results they had predicted before the regulation went into force. And as with the retrospective analysis, there should be a time limit for conducting these new rulemakings.

The third extension would be I think we really need a triggering mechanism to ensure that retrospective evaluations occur and, when appropriate, for new rulemakings to be undertaken within the prescribed time periods. One approach would be for agencies to announce publicly and post on the Web the deadline for a rule's review and reconsideration. A stronger and probably likely preferable approach would be for judicial action to compel reviews and rulemaking in the cases when an agency has failed to comply with a review timeline or to act upon its results.

There are at least two difficulties with the approach that I have just outlined. Many agencies do not have the staff, expertise, or the resources necessary to undertake these reviews. Further, the process of self-evaluation is challenging for all organizations as it requires them to be completely objective about the work they have been engaging in. Indeed, history is especially unkind to organizations that fail to get outside reviews.

My recommendation, therefore, is to establish a new, independent body for regulatory review. This body could be housed within the legislative branch, and it could be modeled after the Congressional Budget Office or even become a division within the existing CBO.

As you know, before the CBO was established, only the President had a ready source of budgetary and economic data and analysis.

Congress was forced to largely rely on the Office of Management and Budget for this sort of information. And the CBO's invention was an important step in leveling that playing field. The result has been several improvements, and those improvements in the budgeting process have largely been a direct result of the CBO's independence. The budgetary analyses and proposals of all legislators and executive agencies are now created to a higher standard, knowing that they must ultimately stand up to scrutiny by the non-partisan CBO.

This system of budgetary review and economic analysis could be a model for a reorganization of regulatory review. Like the CBO, this new organization would reside in the legislative branch, and it would be founded on non-partisanship and independence. The organization would be charged with conducting independent regulatory impact evaluations.

Such an organization would directly strengthen our regulatory system. Agency analyses would benefit from the scrutiny that they would ultimately receive from this new, independent organization. Further, the results of the retrospective reviews would become part of the agencies' automatic assessments of their regulations that I described above. And I believe that this type of rigorous, independent review would build confidence within the business community and a better sense of transparency for the public.

Of course, the creation of such a body would require resources, which are difficult to come by in our current fiscal environment, your important work on the Gang of Six notwithstanding. However, I think it is extraordinarily likely that such an office would pay for itself many times over. To put this in context, the current CBO budget is less than $50 million annually. My best estimate is that the new budget for such an organization would be less, perhaps substantially less.

When one contrasts that with the amount of money that regulations—the costs of regulations imposed on the economy, it begins to look like a good deal. Although it is difficult, as you mentioned, to determine the total cost of regulations imposed on our economy, it seems safe to conclude that they can be measured in the hundreds of billions of dollars annually.

By creating a body that can undertake rigorous analysis about the costs and benefits of regulation—both before the regulations go into place and afterwards—policymakers will have better tools for protecting those regulations with great benefits for our society, reforming those regulations that impose unnecessary costs, and potentially culling those that no longer serve their purpose.

To summarize, I propose two key reforms: number one, institutionalize a process by which agencies automatically undertake retrospective reviews of regulations and initiate a new rulemaking when the results from the retrospective analysis differ from the expected benefits and costs before the regulation is implemented; number two, create a new, independent body for rigorous, objective regulatory review that is modeled on the Congressional Budget Office.

We live in a rapidly changing economy and need a regulatory review structure that evolves to meet the new and different needs of our society. The reforms that I have outlined here will allow our

regulatory system to consistently produce rules with benefits that exceed costs, and that would be good for our well-being and good for the American economy.

Thank you once again for inviting me to participate, and I will gladly respond to any questions.

[The prepared statement of Mr. Greenstone follows:]

Statement of Michael Greenstone
Massachusetts Institute of Technology
The Hamilton Project
The Brookings Institution

To be presented to:
Senate Budget Committee
Task Force on Government Performance
"Improving Regulatory Performance: Lessons from the United Kingdom"
November 16, 2011

Thank you Chairman Warner and members of the Task Force on Government Performance for inviting me to speak today.

My name is Michael Greenstone, and I am the 3M Professor of Environmental Economics at the Massachusetts Institute of Technology, the Director of the Hamilton Project, and a Senior Fellow at the Brookings Institution. My research focuses on estimating the costs and benefits of environmental quality, with a particular emphasis on the impacts of government regulation.

I appreciate the opportunity to speak with you today about how we might improve the government's system of regulatory review. Under all economic circumstances, regulatory efficiency and clarity are crucial objectives for the credibility and predictability of the government's role in the marketplace. However, given the current economic climate, it is absolutely essential to design a regulatory structure that protects the well-being of our citizens without imposing unnecessary costs on American businesses and society as a whole.

We can achieve these objectives without compromising our values in key areas ranging from the protection of public health to the supervision of financial markets by ensuring that the Executive and Legislative branches have the tools of analysis and measurement they need. The purpose of my testimony is to describe in concrete terms how this can be accomplished.

Introduction

American government, at every level, regulates a broad array of social and economic life. Regulatory policy determines the air we breathe, the quality of the water we drink, the materials we use to construct our homes, the cars we buy, the rules that govern our employment contracts, the loans we can take out, the investments we make, and much more. Government regulates these activities because in cases of market failures, for example, our free market system does not create the necessary incentives for businesses and individuals to protect the public good.

But, in making decisions about regulations, public officials must choose which areas of our lives merit government rules, as well as how stringent those rules should be.

The Clean Air Act is a classic example of a regulation with significant benefits and costs. Before its passage in 1970, there were few constraints on businesses that emitted pollution as a byproduct of their operations. The result was poor air quality. As one small example, it was common for white collar workers in Gary, Indiana to bring an extra shirt to work because the first would be dirty from the air and unfit for wear by midday. Even more importantly, some of my research, as well as research by others, has found that the polluted air led to elevated mortality rates that reduced the lifespans of the American people.[1] Obviously, no business sets out to cause these impacts; but, in trying to maximize their profits, it was not in their interest to install expensive pollution abatement equipment when their competitors did not. As a result, they did not act to adequately reduce emissions.

At the same time, the Clean Air Act's regulations cause firms to alter their production processes in ways that raise their costs. Indeed, some of my recent research finds that an important set of Clean Air Act rules has raised polluting industries' costs of production by roughly 2.6%. This has reduced firms' profits and led to higher prices for consumers. Further, it has caused regulated firms to scale back their operations, which led to employment losses.[2] Although the ultimate effect on the level of jobs in the economy is likely minimal, recent research indicates that workers who lose their jobs due to regulation often face prolonged periods of unemployment and become reemployed at lower wages.[3]

The challenge is for regulators to set rules with benefits that exceed their costs. This seems basic, but a weakness in our regulatory system is that we generally do not have the information necessary to make these judgments. This is because the historical approach to U.S. regulation is to evaluate these regulations' *likely* benefits and costs *before* they are enacted. This is the point when we know the least because the regulations are untested. Once a regulation is implemented, it goes on the books and generally stays there unexamined for years and in some cases decades.

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[1] Kenneth Chay and Michael Greenstone, "The Impact of Air Pollution on Infant Mortality: Evidence from Geographic Variation in Pollution Shocks Induced by a Recession," *Quarterly Journal of Economics*, 2003, 118(3).
Olivier Deschenes, Michael Greenstone and Joseph Shapiro, "Defending Against Environmental Insults: Drugs, Emergencies, Mortality and the NOx Budget Program Emissions Market," Department of Economics, MIT (2011).

[2] Michael Greenstone, "The Impacts of Environmental Regulations on Industrial Activity: Evidence from the 1970 and 1977 Clean Air Act Amendments and the Census of Manufacturers." *Journal of Political Economy*, 2002, 110(6); Michael Greenstone, John A. List and Chad Syverson "The Effects of Environmental Regulation on the Competitiveness of U.S. Manufacturing," Department of Economics, MIT (2011).

[3] Reed Walker, "The Transitional Costs of Sectoral Reallocation: Evidence From the Clean Air Act and the Workforce," Department of Economics, Columbia University (2011).

President Obama's recent regulatory reform proposal, spelled out in Executive Order 13563, is a revolutionary step in the right direction. Specifically, it requires that agencies routinely revisit the measurement of costs and benefits of existing regulations and identify the least costly ways to achieve a regulation's goals. I applaud this very important first step.

In the remainder of my testimony, I will identify some ways to extend this important reform so that our regulatory system consistently produces rules with benefits that exceed costs.

I. Extending Executive Order 13563

There are three reforms that build on Executive Order 13563 and would ultimately make the United States' regulatory policy more effective. In keeping with the theme of today's hearing, let me note that these reforms are consistent with the United Kingdom's requirement of analyzing regulations' benefits and costs both before and after their implementation.

First, I recommend institutionalizing the retrospective review of economically significant rules in a public way so that these reviews are automatic in nature. In the case of rules that are currently in force, this would mean publicly committing to a retrospective analysis of each existing rule within a pre-specified period. This might be 5 or 10 years, with the length of time depending on the particulars of the rule and the results of any previous reviews.

In the case of new rules, the implementing agency would be required to announce a timetable for review with a maximum allowable amount of time, perhaps 5 or 10 years, with shorter time periods being preferable. In addition, the agency would be required to pre-specify the expected benefits (e.g., reduced child mortality rates) and costs (e.g., reduced business profits) so that the terms of the subsequent review would be known in advance. The agency would also be required to identify how these benefits and costs would be measured; this might include the types of data and other information that it anticipates being necessary for review.

Second, the agency should commit to undertaking a new rulemaking when the results from the retrospective analysis differ from the benefits and costs that were expected prior to the rule's implementation. As with the retrospective analysis, there should be a time limit for conducting the new rulemaking. In cases where the realized benefits exceed the costs by a wider margin than expected, there may be further opportunities to maximize net benefits. In cases where the rules are found to be ineffective or unjustified, agencies should identify ways to modify the rules or abandon them. Finally if the original expectation of benefits and costs is confirmed by the retrospective analysis, then there would not be a need for a new rulemaking.

Third, we need a triggering mechanism to ensure that retrospective evaluations occur and, when appropriate, for new rulemakings to be undertaken within the prescribed time

periods. One approach would be for agencies to announce publicly and post on the web the deadline for a rule's review and reconsideration. A stronger and likely preferable approach would be for judicial action to compel reviews and rulemaking in the cases when an agency has failed to comply with a review timeline or to act upon its results.

II. A CBO for Regulations

There are at least two difficulties with the approach that I have just outlined. Many agencies do not have the staff, expertise, or the resources necessary to undertake these reviews. Further, the process of self-evaluation is challenging for all organizations as it requires complete objectivity. Indeed, history is unkind to organizations that fail to get outside reviews of their work.

My recommendation is to establish a new, independent body for regulatory review. This body could be housed within the Legislative Branch, and it could be modeled after the Congressional Budget Office (CBO) or even become a division within the existing CBO.

As you know, before the CBO was established, only the President had a ready source of budgetary and economic data and analysis. Congress was forced to largely rely on the Office of Management and Budget (OMB) for this sort of information. The CBO was invented to level the playing field. Its analyses allow Congress to consider the economic and budgetary implications of new policy ideas. Crucially, the CBO also helps Congress to evaluate the information that it receives from the Executive Branch.[4]

The entire budget process has benefited from the role of CBO. This is a direct result of its independence. The budgetary analyses and proposals of all legislators and Executive agencies are now created to a higher standard, knowing that they must ultimately stand up to scrutiny by the non-partisan CBO.

This system of budgetary review and economic analysis could be a model for a reorganization of regulatory review. Like the CBO, this new organization would reside in the Legislative Branch, and it would be founded on non-partisanship and independence. The organization would be charged with conducting independent regulatory impact evaluations. Some of the organization's activities would be statutory in nature – for example, automatic reviews of economically significant regulations – while other evaluations could be performed at the request of Congressional committees and members.

Such an organization would directly strengthen our regulatory system. Agency analyses would benefit from the scrutiny that they would ultimately receive from this new, independent organization. Further, the results of the retrospective reviews would become part of the agencies' automatic assessments of their regulations that I described above.

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[4] Congressional Budget Office, "CBO Testimony: Statement of Robert D. Reischauer, Director, Congressional Budget Office, before the Joint Committee on the Organization of Congress" (1993). http://www.cbo.gov/ftpdocs/105xx/doc10580/1993_06_10_mission.pdf

And I believe that providing this type of rigorous, independent review would build confidence within the business community and a better sense of transparency.

Finally, this new organization could help to increase the credibility of the regulatory evaluations by developing an explicit checklist to determine the rigor of regulatory analyses. The checklist should favor randomized control trials that are the gold standard in terms of evidence and natural experiments over models and observational studies. A recent Hamilton Project paper provides some other ideas for a check list.[5] Such a checklist could also be issued as guidance by the Administration to its agencies.

Of course, the creation of such a body would require resources, which are difficult to come by in our current fiscal environment. However, I think it is extraordinarily likely that such an office would pay for itself many times over. To put this in context, the current CBO budget is less than $50 million annually. My best estimate is that the new budget for such an organization would be less, perhaps substantially so.

This is a very small amount of money when compared to the costs that regulations impose on our economy. Although it is difficult to determine the total number of economically significant regulations that are on the books, the Office of Management and Budget reviewed 540 major regulations between 2001 and 2010.[6] These are generally economically significant regulations which have an effect of more than $100 million on the economy annually—either in costs or benefits. Consequently, it seems safe to conclude that the total costs of regulations can be measured in the hundreds of billions of dollars annually. It is apparent that we have a lot at stake economically with regard to our regulatory system and the cost of finding out which parts are working could be quite small in comparison.

In the United Kingdom, they have established an independent committee of experts, the Regulatory Policy Committee, to review the evidence and analysis on each regulation and to provide an opinion about the robustness of the evidence. Thus, in many respects, this proposal is similar in spirit to what already exists in the U.K.

By creating a body that can undertake rigorous analysis about the costs and benefits of regulation – both ex-ante and ex-post – policymakers will have better tools for protecting those regulations with great benefits for our society, reforming those regulation that impose unnecessary costs, and potentially culling those that no longer serve their purpose.

IV. Conclusions

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[5] Ted Gayer, "A Better Approach to Environmental Regulation: Getting the Costs and Benefits Right," Discussion Paper 2011-06, The Hamilton Project, Brookings Institution (2011).
[6] Office of Information and Regulatory Affairs, Office of Management and Budget, "2011 Report to Congress on the Benefits and Costs of Federal Regulations and Unfunded Mandates on State, Local, and Tribal Entities" (2011).

In conclusion, our regulatory system is a linchpin of our well-being. It allows us to live longer and healthier lives, among many other important impacts. However, these important benefits come with direct economic costs. The purpose of my testimony has been to identify some reforms that will help to ensure that our regulatory system does its job in the most cost-effective way possible – in which the benefits to society exceed the costs.

To quickly summarize, I propose two key reforms:

1. Institutionalize a process by which agencies automatically undertake retrospective reviews of regulations and initiate a new rulemaking when the results from the retrospective analysis differ from the expected benefits and costs.

2. Create a new, independent body for rigorous, objective regulatory review that is modeled on the Congressional Budget Office.

Both of these reforms are similar to the successful reform of the U.K. regulatory system that is the topic of today's hearing. Thus, the U.K.'s experience bolsters the case for these reforms.

We live in a rapidly changing economy and need a regulatory review structure that evolves to meet the new and different needs of our society. The reforms that I have outlined here will allow our regulatory system to consistently produce rules with benefits that exceed costs. That would be good for our well-being, and good for the American economy.

Thank you once again for inviting me to participate in this discussion. I will gladly respond to any questions.

Senator WARNER. Thank you, Dr. Greenstone. I am looking forward to asking you whether the One-in, Out-out or regulatory PAYGO approach might be a component of that.

Mr. Kohli, since we have been joined by Mr. Thune, if you could also take a moment, and since you were involved in some of the—very involved before joining CAP and the British regulatory reform process, maybe a couple of comments as well to bring Senator Thune up to do on our previous panel as well. Thank you.

STATEMENT OF JITINDER KOHLI, SENIOR FELLOW, CENTER FOR AMERICAN PROGRESS

Mr. KOHLI. Mr. Chairman and members of the Task Force. I am pleased to be here to talk about the U.K. experience with regulatory performance. I am going to focus on the period between 2005 and 2009, which is when I was the chief executive of the Better Regulation Executive, effectively the lead official in the British Government for regulatory reform.

I think to take a moment to talk about context first, the context in the U.K. is similar to many other European countries? We have broad consensus that regulation plays an important role in protecting workers and consumers. We even have agreement that regulation is essential to tackle emerging challenges such as climate change. But against that, British businesses often claim that there is too much regulation and that regulations often feel like mere bureaucracy.

Meanwhile, groups such as environmentalists, consumer groups, and trade unions reasoned that new regulations are essential to provide better protection against new and old risks to society.

In 2005, the British Government launched a new initiative to reform regulation, and the starting point was a belief that it is possible to build a system of "better regulation." The idea was the government's role was to find ways to simultaneously maximize regulatory protection while minimizing unnecessary regulatory burden. For example, if a regulatory agency was able to focus inspection resources on those businesses that posed the greatest risk, it might be able to reduce the overall cost to business and improve regulatory outcomes at the same time.

I think there are five key takeaways from the British experience.

First, many who work in government know that what gets measured gets done. Even though British politicians have made numerous statements in the past that they were committed to reducing the regulatory burden, they never measured regulatory costs. In 2005, the Government promised to do precisely that. It promised that it was going to reduce the annual administrative costs of regulation by 3.5 billion pounds. Just to put those numbers in context, the U.K. GDP is about 7 times smaller than the U.S., so that is equivalent to around $40 billion. The target covered costs such as form filling, inspections, providing information, and recordkeeping, but not the direct costs of providing protections such as purchasing safety equipment for workers.

Each agency had to look hard at the regulations they were currently administering and find ways to make them easier for business. In total, there were more than 300 different measures taken across around 20 agencies. Each year every agency published a

progress report setting out how much they had saved business, and independent panels, including business representatives, validated the claimed savings.

For the first time, Government agencies faced real incentives to look at existing regulations and how they could be improved, and this was a real change. Political debate typically is focused on new regulations, whether they should be brought in or whether they should not. And often the energies of officials is in the same place.

A second takeaway is that regulations need to be sensitive to the needs of small business. Small business told government they believed in the purpose of most regulations. They did not want to harm their workers or their consumers. But they struggled to work out what the law required them to do.

Many hired consultants to help them work out what to do, but these consultants made money by exaggerating the real requirements. It was striking how poor government guidance was—long, complex documents written in legal rather than plain English and covered in disclaimers. So the government issued a code of practice on what good guidance looked like, and regulators worked to make their guidance and websites as accessible as possible.

Third, regulators need to be accountable as well. Regulators spent considerable time checking that businesses were complying with laws to protect the environment or safeguard worker safety. But no one checks on regulators to see that regulators are doing all they can to minimize burdens while maintaining protections.

The government set out eight principles for good regulation, such as no inspection should take place without a reason, and then reviewed regulatory agencies against these principles. Review teams included senior staff from other regulators along with independent experts, and they published reports describing how each regulator was performing and recommendations for improvement.

A fourth takeaway is the government needs to better solicit input from business and citizens on where to focus its energy when seeking to improve existing regulation. For example, business complained about delays and inconsistencies in the U.K.'s land-use planning system—approvals that needed to be sought before new construction projects can commence. International surveys also demonstrated that this was a relative weakness for the U.K. So the government conducted a major review working with business and local government to see what improvements could be made to that process.

Another example, business and trade unions were unhappy that a law that had been intended to reduce the number of employment disputes that went to court had actually had the opposite effect. Government agencies worked with trade unions and business to come up with a better way forward. In each case government was clear that protecting the public was essential, but if there was a more effective and less frustrating way to do so, it should be adopted.

A final takeaway from the U.K., government needs a strong institution charged with improving regulation. What we were trying to do in the U.K. was an enormous change of focus across dozens of regulatory bodies. To succeed, we needed a strong group of people in government charged with driving the reform forward. We looked

far and wide for the best people. At one point we had a dozen nationalities in the unit. We were always looking for ways to improve and constantly sought the advice of business, consumer groups, trade unions, regulators, the legislature, and colleagues in other countries.

The U.K. initiatives over this period were effective. The target to reduce administrative burdens by 3.5 billion was met. And there was a noticeable improvement in the perception of regulation. By 2010, 47 percent of businesses said that understanding what they needed to do to comply with regulations was easy—10 percent higher than in 2007. That is not high enough, but certainly an improvement. The OECD reported in 2010 that progress in Britain was ground-breaking by international standards.

The new government that took office in Britain—and you have already heard about what they have been doing from Graham and Johannes—has built on the reforms instituted by the last government.

In concluding, I want to underline that international comparisons are difficult in this area. Not only is the institutional context different, the United Kingdom has a parliamentary system of government, the United States does not. But we also have a different regulatory culture with broad, bipartisan acceptance in the U.K. of the importance of regulation to safeguard the public at large and even to tackle issues such as climate change.

I will leave it to others to determine the extent to which the U.K. experience are lessons for the United States.

Thank you so much.

[The prepared statement of Mr. Kohli follows:]

Testimony before the Senate Budget Committee on "Improving Regulatory Performance: Lessons from the United Kingdom"

Jitinder Kohli
Senior Fellow, Center for American Progress Action Fund
November 16, 2011

Mr. Chairman, members of the taskforce, I am pleased to be here to talk about the U.K. experience with regulatory performance.

There are two points I should note at the outset. First, while I have expertise on how government can reform regulation, I am inexpert on the U.S. regulatory context and debate. My work in Washington has intentionally had a different focus, and so others who have expertise in the U.S. context should determine the extent to which the experience of the United Kingdom is relevant here. Second, these are my personal views and are not necessarily those of my colleagues at the Center for American Progress.

The United Kingdom has had a policy framework on regulatory reform in place for 25 years, and over those years, there has been a considerable evolution of the policy. In this testimony I focus on the period from 2005 to 2009, when I was the chief executive of the Better Regulation Executive. As such, I was the lead official in the British government responsible for regulatory reform.

The context in the United Kingdom was similar to that in many European nations and did not suffer from the polarization around the issue of regulation that you appear to have in this country. There was broad consensus that regulation played an essential role in providing protections for our citizens and quality of life. No one argued that we did not need regulations to protect workers, or consumers, or provide clean air and water, and there was even agreement that regulation was needed to tackle emerging challenges such as climate change. And yet British business often claimed that there was too much regulation, and in many cases regulatory oversight felt like mere bureaucracy. As a result, they called on government to reduce the burden.

Meanwhile, as technology, science, and cultural norms developed, groups such as environmentalists, consumer groups, and trade unions reasoned that new regulations were needed to provide better protection against risks to society. Politicians found themselves caught between these two forces—both of which they wanted to satisfy.

In 2005 the British government launched a new initiative to reform regulation. Developed jointly by then-Prime Minister Tony Blair and Chancellor of the Exchequer Gordon Brown, this initiative tried to look at the issue in a new manner. The starting point was a belief that it was possible to build a system of "better regulation." The idea was that instead of government allowing itself to be caught between those who wanted more regulation and those who wanted less regulation, government's role was to find ways to simultaneously maximize regulatory protection while minimizing unnecessary regulatory burden. For example, if a regulatory agency could focus inspection resources on those businesses that posed the greatest risk, it might be able to reduce the overall cost to business and improve regulatory outcomes. Effective regulation could also improve respect for rules among the regulated and positively change the perception of government among businesses. There are five key takeaways from the British experience.

First, many who work in government know that "**what gets measured gets done.**" But even though British politicians had made numerous statements in the past that they were committed to reducing the regulatory burden, they had never instigated a process of measuring regulatory costs. In 2005 the U.K. government promised that as part of the Better Regulation agenda, it would reduce the annual administrative costs of regulation by £3.5 billion (around $5.5 billion) within five years. Britain's gross domestic product is about seven times smaller than the United States, so that's equivalent to around $40 billion. This target covered costs such as form filling, inspections, providing information, and recordkeeping, but not the direct costs of providing protections such as purchasing safety equipment for workers.

To achieve this objective, each agency had to make a contribution to the overall goal, which led each one to look hard at the regulations they were currently administering, and to find ways to make them easier for business. Technology helped enormously because at many agencies, the main way to save money was to replace paper forms with electronic systems. Not only did this save business money but it also helped agencies as it was much easier to process data collected electronically. In total there were more than 300 different measures taken across around 20 agencies. Every year each agency published a progress report setting out how much they had saved business. Independent panels including business representatives validated the claimed savings.

One important effect was that government agencies faced real incentives to look at existing regulations and how they could be improved. That was a new experience for many government officials; in the past, the main focus of attention was on new regulatory approaches. As political debate was largely focused on whether and how to respond to calls for new regulations to deliver protections, that was where the energy of government employees was also focused. By insisting that each regulatory agency also look for ways to improve the way existing regulation worked, we were able to ensure that agencies also put significant energy in finding ways to streamline existing regulations.

This initiative, focused on existing regulation, complemented measures that were focused on new regulatory proposals. For proposed regulations it remained important to carry out impact assessment to establish costs and benefits of regulatory proposals. Like the United States, the United Kingdom had in place systems and processes to consider the benefits and costs of proposed regulations (which also covered legislation). This was an important foundation for the reforms that we carried out.

Second, **regulation needs to be sensitive to the needs of small businesses**. To achieve that, government officials need to understand the perspective of small firms. Small businesses told government they believed in what most regulations were trying to achieve. They did not want to harm their workers, or their consumers. But they struggled to work out what the law actually required them to do.

Many hired consultants to help them but these consultants sometimes made money by exaggerating the requirements. Some businesses did nothing and hoped they would not be caught out. It was striking how poor government guidance was—long, complex documents written in legal rather than plain English, and covered in disclaimers. Few officials in the agencies even knew how difficult it was to make sense of their own guidance or how hard it was to find documents on their own websites. So the government issued a code of practice on what good guidance looked like and regulators worked to make their guidance and websites accessible and useful for small businesses.

Third, **regulators need to be accountable as well.** Regulators spent considerable time checking that business was complying with laws to protect the environment or safeguard worker safety. But no one ever spent time checking to see whether the regulators were doing all they could to minimize burdens while maintaining consumer, labor, and other protections. So the government set out eight principles of modern regulation (such as "no inspection should take place without a reason") and then reviewed officials against these principles. Review teams often included senior staff from other regulators along with independent experts. They published reports describing how each regulator was performing and set out recommendations for further improvement.

Fourth, government needs to better **solicit input from business and citizens** on where to focus its energy when seeking to improve existing regulation. Business, for example, complained about delays and inconsistencies in the United Kingdom's land-use planning system (approvals that needed to be sought before new construction projects could commence) and international surveys demonstrated that was a weakness by international standards. So the government conducted a major review working with business and local government to see what improvements could be made to the process.

Similarly, business and trade unions were unhappy that a law that had been intended to reduce the number of employment disputes that went to court had had the opposite effect. So government agencies worked with them to come up with a better way forward. In each case government was clear that protecting the public was essential but if there was a more effective and less frustrating way to do so, it should be adopted.

Lastly, the U.K. experience showed that government needs a **strong institution charged with improving regulation**. What we were trying to do in Britain was an enormous change of focus across dozens of regulatory bodies—and that's far fewer bodies than you have here. To succeed, we needed a strong group of people in government charged with driving all this reform forward. So we built an agency with a clear mission to maintain protections for the public while minimizing unnecessary costs of existing and new regulations. We looked far and wide for the best people (at one point, there were a dozen nationalities working in the Better Regulation Executive office) and fostered a culture of constant improvement. We were always looking for ways to improve our strategy to achieve our goals and constantly sought the advice of business, consumer groups, trade unions, regulators, the legislature, and colleagues in other countries.

The U.K. initiatives over this period were effective. The target to reduce administrative burdens by £3.5 billion was met. And there was a noticeable improvement in the perception of regulation. By 2010, 47 percent of businesses said that understanding what they needed to do to comply with regulations was straightforward—10 percent higher than in 2007.[1] The Organisation for Economic Co-operation and Development reported in 2010 that progress in Britain was "groundbreaking by international standards."[2]

The new government that took office in Britain last year has built on the reforms instituted by the last administration as you have heard earlier from Graham Turnock and Johannes Wolff. Measurement is at the heart of the "one in, one out" regime. The new government is also redoubling efforts to listen to the views of the public and businesses when deciding which existing regulations to review. And there is a special focus on ensuring that regulations are sensitive to the needs of small business.

In concluding, I want to underline that international comparisons in this area are difficult. Not only is the institutional context different—the United Kingdom has a parliamentary system of government, and as a member of the European Union much of our legislation comes from Brussels. But we also have a very different regulatory culture with broad, bipartisan acceptance of the importance of regulation in safeguarding the public at large. One example of that is on climate change, where business and politicians largely agree that government needs to take decisive action. I will leave it to others to determine the extent to which, if at all, the U.K. experience is valuable in American context.

Endnotes

[1] National Audit Office, "Business Perceptions Survey 2010" (2011), available at http://www.nao.org.uk/publications/1011/business_perceptions.aspx.
[2] "Executive Summary," available at http://www.oecd.org/dataoecd/61/60/44912018.pdf.

Senator WARNER. Thank you, gentlemen. I will just ask a brief question or two and make sure my colleagues get a chance, and then I will come back to you.

Dr. Greenstone, I want you to speak again a bit about your retrospective process, and, Mr. Kohli, I would like you as well. One of the concerns or one of the things as I have dove into this is, you know, there are not the appropriate incentives to go back and clean out regulations that have outlived their time, usefulness. And while I know both of you have some concerns about the One-in, One-out or my regulatory PAYGO approach, I would be curious on both of your comments on the One-in, One-out that was described by the first panel, doesn't that really get—doesn't that align the incentives right at least to make sure that retrospective review is done in an appropriate manner? And, secondly, one of the things that the last panel brought up is that the British have set up something called the RPC, which is kind of an independent entity that helps do the cost/benefit analysis, that too often we see here in this country an analysis done where industry will say the regulation costs a gazillion, and the public interest group will say the benefit is five gazillion, and we are then left with kind of one-off stories.

So I would love your comments on that, both of you.

Mr. GREENSTONE. Thank you, Senator, for the opportunity to speak to this. There is a lot of appeal to the One-in and One-out. I think, as you highlighted, a big part of that appeal is that, you know, it focuses a really bright light on the cost of regulation, and that is one that I think agencies and regulators may not always take into account properly.

I think its potential weakness is that it is just focusing on one side of the coin.

Senator WARNER. You have got to have the benefit of the side in there at some point.

Mr. GREENSTONE. Yes. And at some point, I think without—and as I understand the One-in and One-out in Britain, it is entirely focused on the cost side. And, you know, what that rises the possibility of is suppose we wanted to reduce the costs of our regulatory system. Well, probably the first thing we would do is repeal the Clean Air Act because it has got to be the most expensive set of regulations on the economy. And the downside, of course, is that we would lose all the benefits that that produces. You know, people live much longer and healthier lives than they did before the Clean Air Act.

So, you know, my own view is that I would prefer a policy that shook up the system and got people to focus on the benefits, finding regulations where the benefits exceed the costs, not just identifying ones that have costs. And as I tried to say in my testimony, I think a very good way forward for that is to institute a system of automatic retrospective reviews. Currently, the system, it does not operate like any business that you have ever heard of.

Let me use an analogy. The way it works, an analogy would be you think about hiring someone, you get their resume, you call their references, you hire them, put them at a desk, let them do their thing for years and years and years, never find out if they did a good job. So no business would ever operate like that. And what I think we need currently or what I think the system needs is an

automatic kind of job performance evaluation for the regulations to assess without the benefits and the costs.

Then the second part of that, which also you alluded to, is right now you have a lot of people shouting at each other about the costs are high and the benefits are great, and those are all people who kind of have skin in the game one way or another. And I think what the system would really benefit from is a kind of independent, dispassionate voice on that, and we do not really have that right now.

Mr. KOHLI. I think one of the issues we found in the U.K. was that agencies did not put enough resources into thinking about how to improve existing regulation. Sometimes that was, you know, something as mundane as the form being badly designed and hard for someone to make sense of. And just redesigning the form or enabling the process could potentially save business money and save frustration and irritation.

So what we were trying to do through the admin burden process was really about giving people in agencies an incentive to look to find simplifications, look to find simplifications, look to find better ways of doing things without reducing the protections that regulation provided. And so I think that is a very, very important thing to do. Finding ways to incentivize people to make existing regulations work better is absolutely essential.

I think there are key differences between the U.S. and the U.K. in terms of the applicable of One-in, One-out. You know, one difference is the U.S. has separation of powers enshrined in the Constitution and we do not in the U.K. So the idea of our legislature coming up with ideas which then the executive branch has to implement just does not mean anything in the U.K. context. Actually, you get to be the government of the day by controlling the legislature, and so when the government of the day in the U.K. says we can take these regulations out, they can be fairly sure that the legislature is going to follow suit. And that is a very, very big difference between the U.S. and the U.K., so that would have an impact.

In terms of independent scrutiny, I was in the Better Regulation job when we made the decision to set up the Regulatory Policy Committee, and one of the reasons we did that was because we felt that while the quality of impact assessment in the U.K. has increased significantly and, therefore, we were much more confident about the quality of our estimation of costs and benefits, we still felt that there was a risk that agencies could just have got it slightly wrong or, worse, there could be a perception that agencies were coming up with cost/benefit numbers that were more in their favor than the reality. So even if the reality was not so different, you know, the perception could be the agencies were not quite in the right place.

And so having the Regulatory Policy Committee tell us when the numbers were not right felt to us like a good thing to do, which is why we set up—as a precursor to the RPC—we set up a panel that did the same process but for administrative burden savings. So we had that in place for admin burdens, but we did not have it in place with for cost-benefit analyses through the impact assessment process.

Senator WARNER. Senator Thune.

Senator THUNE. Thank you, Mr. Chairman, for holding the hearing. Thank you for being here today, and as you have correctly observed, there are differences between your system and ours, and it makes it, I think, much easier in the U.K. to be able to rein in regulations that perhaps are not conducive to any public purpose and also have a cost that really puts a burden on your economy.

In our country, you know, obviously, we have got the checks and balances, as you mentioned, but we also have a regulatory regime that I think has gotten significantly bigger over time and spins out lots and lots of regulations. And I think everybody here would argue that we need regulation, smart regulation obviously where public health and safety are concerned, but sometimes around here we confuse quantity with quality and think that more is better. And more is not always better. And I think what we are finding, at least what I hear from the job creators and the small businesses in the country today, is that perhaps one if the biggest obstacles that they face when it comes to creating jobs is just this excessive regulation that drives up the cost of doing business in this country.

I guess I am curious, given the fact that regulatory agencies in the United States are independent of Congress, and even though regulations are supposed to implement laws passed by Congress, there is great latitude that is exercised by the regulator when it comes to achieving a law's intent, and that interpretive power I think grows over time as laws become older and their authors and supporters leave the public arena. And if a regulation goes beyond the scope of what Congress intended under the Congressional Review Act of 1996, Congress has only 60 days to disapprove the rule before it takes effect. So there is a real limited time frame there in which Congress can be heard on this.

So, you know, once the regulatory process begins, the congressional role becomes very much a reactionary one and a somewhat secondary position.

So I guess what I would like to ask perhaps both of you to react to, and, Mr. Greenstone, one of the things that many of us have advocated and talked about here is a biennial budget process where Congress would budget and appropriate funds in odd-numbered years and use even-numbered years to do more oversight, more regulation. And I guess—could you see this Committee having a role in terms of doing regulatory review as part of an off-year performance review process?

Mr. GREENSTONE. Thank you for the question, Senator. I think—so I think you have hit upon some important points which is there really is a sense out there that it is difficult for businesses due to the regulations they face, and what I would like to add to that is, it is made all the more difficult for legislators and policy makers, that we never find out which regulations are providing benefits and which ones are providing costs.

And so, I think any system that shines more sunshine on the process and allowed the identification of the ones that were working and the ones that were not working so well, potentially with this Committee's involvement, would be an improvement.

So really the only two principles I think are important are finding out what works and what does not and making sure we find

it out from independent sources, and just as the One-in, One-out is aimed to put some pressure on the system, I think sunshine could put pressure on the system. So I think you are correct about that.

Senator THUNE. Do you think Congress ought to have a more proactive role when it comes to maybe even approving regulations? In other words, instead of the current disapproval process where Congress has to take a vote on a resolution of disapproval to prevent a regulation from taking effect, should Congress have to have more of a role when it comes to approving, particularly major regulations, perhaps before they take effect?

Mr. GREENSTONE. I think that is probably speaking out beyond my expertise. I think it seems to me there should be some pluses, which is that there be a further check on the system, and then I think there is some minuses. I know that all of you are pulled in many directions already and it seems like it would take on the risk of having to pass legislation, re-pass legislation every single time there was a new rule. So I am not the best person to judge that.

Senator THUNE. Mr. Kohli, could you just react to the idea, the notion that Congress, through its annual budgeting process, by going to a biannual budget in which we appropriate funds in odd-numbered years and even-numbered years could do more oversight when it comes to agencies and some of these what we perceive, at least I perceive, to be regulatory excesses and how that might—I know you have a very different system which creates lots of different opportunities to do this, but we would have to create some sort of mechanism here that would allow for that.

Mr. KOHLI. Well, I think the thing to remember about regulation is that it is incredibly hard. You know, that is an obvious point at one level, but actually if you think of what a regulation is, somebody has the idea that they want to achieve a change in behavior in society at large by changing the law of the land, and they hope that by changing the letter of the law, that society behavioral change will result.

Now, with all the best will in the world, that will sometimes not go in the way people would intend and I absolutely agree with the points that Michael was making earlier. And anything that shines light on that process and looks to see whether those regulations are having the effects they originally intended or whether there are ways to have those effects in a less costly manner, or whether there is a need for more regulation in that space in order to achieve the effects that actually people agree on, you know, those kind of reviews would be a good thing.

Now, how those reviews are conducted is beyond my expertise, but certainly in the U.K., we were of the view that there is not enough scrutiny of legislation or regulations that have been on the books for a long time and there is a lot of scrutiny of regulations that people are considering bringing in now.

Senator THUNE. Thank you, Mr. Chairman. My time expired. Thank you very much.

Senator WARNER. Thank you, Senator Thune. I do not agree with you completely on that two-year budget cycle. I get a little concerned, as a former business guy, with the needs for predictability of reinserting Congress in another way on all of the regulations. I

do think Dr. Greenstone's notion of an independent entity that could help us make that assessment and I am very concerned that none of the retrospective efforts we have had so far have worked, and one of the reasons why I am so intrigued with the One-in, One-out approach. Senator Whitehouse.

Senator WHITEHOUSE. Just to respond to Senator Thune on the two-year cycle, I think we may be better biting off the two-year budget piece rather than trying to fight through the budget and the appropriations piece because that could be the bridge too far and I would rather at least get the partway that we can rather than take on a fight that will make it perhaps a vain effort.

So I assume the two of you are both familiar with the concept of regulatory capture? Yes, okay. My worry is that first of all, regulatory capture has intellectual foundations that go back a hundred years. Nobel Prize winning economists write about it. Administrative law textbooks write about it. It has virtually bomb-proof academic support and background.

And yet, once you get into the world of regulatory capture, of politics and of government, we tend to do nothing about it and nobody takes much interest. So that is sort of a baseline problem. You add to that that I think Washington is at a particular low point in terms of both intellectual honesty and corporate power, perhaps not unrelatedly, by the way, and that the problem that underlies regulatory capture could create a problem of what I would call deregulatory capture, which is, how do you protect your deregulatory efforts from—how do you keep them on the up-and-up?

How do you keep them legitimately focused on truly obsolete, unnecessary, wasteful regulations, truly on the better mousetrap, rather than have suddenly the polluting industry decide, Ah-health, we are done with the Clean Air Act now.

I mean, we hear a lot in this body about regulatory reform. When you pull the curtain, it is gut the Clean Air Act. It is not regulatory reform. We hear about balancing the budget and you pull back the curtain and it is kill Medicare. It is not really balancing the budget.

And so, the danger of overreach in this area and the danger of special interests like the health insurance industry that would like to take over Medicare, and the polluting industries that would like to have the Clean Air Act gutted so that they can save a dollar and cost the rest of us $30 in well-being and other savings, I do not see how you—tell me how you firewall out of your deregulatory process the same forces of corporate power and intellectual dishonesty that drives regulatory capture in so many other areas.

We saw it with the BP-Halliburton oil spill in MMS. We saw it with the investment banks telling the SEC that it was okay to go to 30 times leverage. We see it with the mining accidents and the Mine, Health, and Safety Administration being gone and only doing what the big mining companies will let them do.

So I really, really worry that when that is your baseline and now you add the deregulatory component to it, that just becomes something that those same special interests want to take over and pretty soon your regulatory reform effort has turned into gutting the Clean Air Act and killing Medicare.

Mr. GREENSTONE. Well, Senator Whitehouse, I know you have—thank you for that question and I know you have sponsored some important legislation in this area. I think it is——

Senator WHITEHOUSE. You may be the only person in Washington who knows that other than myself, so thank you.

Senator WARNER. I gave you the shout-out in my opening statement about your——

Senator WHITEHOUSE. Oh, good. This is more publicity than that has received so far, and I mean in a town that could not be less interested in regulatory capture other than trying to accomplish it.

Mr. GREENSTONE. Well, we have got a crackerjack staff at the Hamilton Project and we have got a nice write-up on your legislation.

I think what I would just add to the important points you are making is that in the current approach where we never find out what regulations do, that leaves a vacuum, and in that vacuum people who have vested interests, be they corporations that pollute or environmental groups or whoever it is, can step into that and there is no referee to say, What you are saying does not square with the data, it does not square, there is no evidence for that.

Senator WHITEHOUSE. So you need an IG or a GAO or a CBO or a neutral, fair, constant score keeper and referee?

Mr. GREENSTONE. Actually there are two features. One, you have to accept that what you should do is go back and find out what the regulations did. As Senator Warner said a couple minutes ago, we have had a very haphazard and weak commitment to doing that. So the first step is agree that you are going to do that and that you will use the evidence to change the system going forward.

The second is, as you said, you need a neutral score keeper. My own personal view is something like the CBO or given CBO duties like that could help. I am sure there are other ways to achieve the same thing. The British system sounds intriguing to me as well. But the main thing, I think, is you need actual information and then that information has to be unbiased.

Senator WHITEHOUSE. Even in that case, I would argue that does not cure the capture problem. I mean, when you look at OMB as sort of an example of somebody that is supposed to be above the fray and to give honest information, if I am not mistaken, it was OMB that refused to open the Clean Air Act email that would have triggered the process of allowing that regulation to go forward in the Bush Administration. So clearly, somebody had said, Do not open that email and that stops the process, and that is hardly the hallmark of a neutral body.

So I think I accept your notion that there needs to be a referee, but all that does is narrow my worry to how do you keep the referee honest. Mr. Kohli.

Mr. KOHLI. Well, first of all I want to agree with the points that Dr. Greenstone made in terms of the need of a neutral arbitrator. I think just reflecting back on the U.K. experience, we were very clear it was about building a better mousetrap. This was not an experience of removing protections. We did not want to do that.

Both Tony Blair and Gordon Brown, who were the two political leaders of our process in the U.K., made that extremely clear both publicly and privately, that this had to be about better regulation,

and there surely were ways of getting existing regulations and making them work better such that outcomes were maintained or potentially even improved.

And that was a challenge. People had to think in a different way about that issue because it was not a conventional way of thinking. Too often people thought this was about whether you have the regulation and whether you can get rid of it or freshen it, and I would see sometimes it was not about that.

Sometimes it was about things as boring and mundane as—you know, I am thinking back to an example. We had a new law that we brought into the U.K. where licensed premises had to seek—had to seek consent. So if you were going to serve alcohol on the premises, then you had to seek consent.

And somebody somewhere in the system had decided that everybody who had a licensed premise had to submit a plan of the building in which they proposed to serve alcohol. Now, this, at one level, they felt like a reasonable idea, but actually it hit every hotel cinibar. And the rules were that the plan had to be done at a particular scale which the government official had decided was the right scale.

And the person was not trying to do the wrong thing. You know, they were not being malicious. It was not anything like that. It was just—it was almost accidental. But in some cases, that led to significant costs and costs that could have been avoided.

And there were examples the other way. There were certain examples where the effect of the current regime were that the costs were lower than they should have been and protections were lower than they needed to be, and this was about trying to find that balance, trying to improve the quality of regulation. And that was hard.

But I feel that that was the task ministers gave us and that was the task that we felt we were responsible for delivering for them.

Senator WHITEHOUSE. So the consistent message from the political establishment was what really made that possible?

Mr. KOHLI. Yeah. In the U.K. at that time, it was very clear this was a better regulation agenda and that was the language that we were meant to be using and that was the language we were using.

Senator WHITEHOUSE. That is also the language the special interests would use. They are not going to come in red, and tooth and claw and say, Here we are to make things unhealthier for Americans because it is better for our bottom line. They will always mask what they are trying to accomplish.

Mr. KOHLI. But they might say deregulation. Ministers at the time were clear, that is not what they were interested in. They were interested in improving regulations—taking the regulatory stock and seeing if you could make it work better, alongside bringing in new regulations to tackle new issues.

Climate change, which was a new issue that we were seeking to tackle in the U.K., where we had bipartisan agreement in the U.K. that we wanted to be the most ambitious country in the world in terms of tackling climate change, we were bringing in lots of new regulations in that space. But for each of them, the point that Dr. Greenstone made, applied.

They were hard and coming back to review to see whether they actually worked was important, because what was our objective on climate change? It was to reduce carbon emissions, not to bring in regulations, and you can be sure that some of the regulations we were designing were going to reduce carbon emissions more than we expected and some of them were going to reduce carbon emissions less than we expected.

And actually going back and looking at the stock of regulation three, five years hence and revising it so it worked better was very, very important.

Senator WHITEHOUSE. Makes me long for that type of a discussion. I do not think we can even have a discussion about whether climate change is happening in this particular country right now, notwithstanding that 98 percent of climate scientists all agree there is—it sort of proves my point that you have got a special interest behind this stuff, you have got intellectual dishonesty, and suddenly you get a real problem on your hands. So I salute you for having kept it out of that morass. But I think it is a real challenge.

Senator WARNER. I know you feel strongly on this, but let me just respond. I mean, I concur with what Senator Whitehouse said. There is that potential of capture. I would also argue that there can be capture on the other side as well when we say every new project in America is going to take seven to eight years to do an EIS statement even if the project is going to bring advanced rail or do enormous things that have other benefits that do not get focused into our current regulatory environment.

I think it again comes back to Dr. Greenstone's position, that you do need some independent arbiter here and CBO, by Lord knows, is not perfect and we have both had our concerns with their scoring processes on health care reform and others, but there is—it does not change each time the keys to the White House change.

Senator WHITEHOUSE. Yeah.

Senator WARNER. Because we are caught in this conundrum right now where we see saying regulatory burdens at $50 billion a year, others saying $1.76 trillion. Folks use that wide discrepancy in such a large way that there is no appears to be fair balancing. I very much feel, and I have had some conversations with others that say, you know, as you look at the approach I have looked at or the regulatory payload, you have got to make sure you do factor in the benefit side of the equation. I get that.

But the notion, to go back to my first slide, since 1997, on average, 3,000 to 4,500 new regulations a year under D's and R's, actually many times more under Republican administrations. Yet, very little of that—I would be curious over the 40,000 that have been implemented in the last decade, how many of those regulations have ever been actually eliminated, refined, reduced away, as Mr. Kohli said that they did in the U.K. that might then change at least the perception out there that we have burdened on.

And some of our colleagues thinking this burden only just started in the last 24 months, this enormous, enormous cost on doing business. We have got to find a way to sort through this.

Senator WHITEHOUSE. The Administrative Conference was an organization that existed for quite some time and I think its intended purpose was to have a kind of advisory role in this area. It was put

out of business, I believe, maybe seven or eight years ago and it has just been reconstituted. Do either of you have any thoughts about the Administrative Conference? Are you familiar with it?

Mr. KOHLI. Yeah, I have met with them and I think that the work they do and the work they could do in this area could add enormous value because, you know, they are exactly the kind of body that does not have the risk of regulatory capture and it is a deliberative body that looks for better ways to achieve the kind of outcomes that society has decided it wants. So I have enormous respect for their work in its very early days, because as you say, they have just been reconstituted, but they could potentially have a significant impact in this space, yes.

Senator WHITEHOUSE. Great. Okay.

Senator WARNER. Last word, Dr. Greenstone?

Mr. GREENSTONE. I am not familiar with the Administrative Conference.

Senator WARNER. Well, let me thank the witnesses, as well as my colleagues, for their participation. For the information of Senators and staff, because of the late start of today's hearing, the time for Subcommittee additional statements or questions for the record will be extended until noon tomorrow. With that, the hearing is adjourned.

[Whereupon, at 4:16 p.m., the hearing was adjourned.]

Opening Remarks –Regulatory Performance
Hearing 10/16/11

Thank you, Chairman Warner, and thank you for your work on this task force. I look forward to hearing today from our witnesses about their experiences and insight from the United Kingdom's efforts in reducing the burden that regulations impose on the economy.

We all know that when an agency issues a new regulation, it puts a new burden on businesses that can hurt the economy. Obviously, in our current period of low growth, the last thing we want to do is increase the burden on business and hamper economic output. But even in good times, we need to be aware of what kind of cost a regulation puts on

our economy and what the benefit of those regulations are.

Just as we need to keep reviewing spending programs to determine their continuing value, we also need to monitor regulations to ensure they are still effective and needed. That is why I'm glad that the GPRA Modernization Act, which Senators Warner helped to enact last year, made a positive step toward better regulatory evaluation. But more can done.

Today, I'm very interested to hear about the *One-In, One-Out* policy being used in the United Kingdom. I think we might call it regulatory Pay-Go on this side of the Atlantic, but as I understand it, a

new regulation is scored for how much of a burden it puts on the economy. Before that regulation can go into effect, it has to be offset by eliminating an existing regulation with an equal or greater economic burden to the economy so that on the whole, no new regulation can cause a greater net burden on the economy.

So, I see here in your testimony Mr. Turnock, that the *One-In, One-Out* policy, has relieved the British economy of almost ten pounds (£10) in regulatory burden for every one pound (£1) in new regulatory cost. I think that is remarkable in an industrialized economy like the UK. I think if we

could do that it would make us more productive and more competitive as a nation.

I think regulatory Pay-Go has a lot of promise – and I hope, Senator Warner – we can work together on doing something similar here in the United States.

I'd also like to point out that the Minority has done a lot of great work in this area already. The *Jobs Through Growth Act*, which is known as the Republican Jobs bill, had several great provisions borrowed from bills that would alleviate the burden regulations put on our economy.

I'd like to highlight two of those bills, which I think are reasonable and exactly what the economy needs right now.

One is Senator Johnson's *Regulation Moratorium and Jobs Preservation Act*, S 1434. This bill simply says that no new significant regulation can take effect until the unemployment rate drops to 7.7%. According to the Bureau of Labor Statistics, unemployment was 9% last month. Senator Johnson's bill defines "significant regulation" as being one that has an annual burden on the economy of at least $100 million.

The other very reasonable approach to regulatory reform I'd like to mention is Senator

Paul's *REINS Act (Regulations from the Executive In Need of Scrutiny Act)*. This act simply says that Congress should have to pass a resolution of approval before a proposed major new regulation can take effect. I think most Americans already think we do that. And, I think that the American people, through their representatives in Congress, should have the final approval of a regulation. I believe members should have to go on record for or against a regulation and defend that position to the voters.

So, I'm encouraged that we're having this hearing. I think Congress needs to be more engaged in the regulatory process. We're way behind in measuring the effectiveness of what we do

as a government. That's true of all our programs, including spending programs. However, we definitely need to get more aggressive on evaluating regulations, and using those evaluations to prevent any undue hindrances to the economy. It doesn't mean all regulation is bad, it just means we don't know what is working and what isn't. But we do know that regulation is a burden on our economy, and that we should not allow those that are ineffective it to continue to drag us down. So, I look forward to hearing from our witnesses today on this issue.

Thank you, Senator Warner.

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