CONGRESSIONAL BUDGET OFFICE PROJECTIONS

HEARING

BEFORE THE

COMMITTEE ON THE BUDGET
HOUSE OF REPRESENTATIVES

ONE HUNDRED SEVENTH CONGRESS

SECOND SESSION

HEARING HELD IN WASHINGTON, DC, JANUARY 23, 2002

Serial No. 107–20

Printed for the use of the Committee on the Budget

Available on the Internet: http://www.access.gpo.gov/congress/house/house04.html

U.S. GOVERNMENT PRINTING OFFICE

77–409 DTP WASHINGTON : 2002

For sale by the Superintendent of Documents, U.S. Government Printing Office
Internet: bookstore.gpo.gov Phone: toll free (866) 512–1800; DC area (202) 512–1800
Fax: (202) 512–2250 Mail: Stop SSOP, Washington, DC 20402–0001

COMMITTEE ON THE BUDGET

JIM NUSSLE, Iowa, *Chairman*

JOHN E. SUNUNU, New Hampshire
Vice Chairman
PETER HOEKSTRA, Michigan
Vice Chairman
CHARLES F. BASS, New Hampshire
GIL GUTKNECHT, Minnesota
VAN HILLEARY, Tennessee
MAC THORNBERRY, Texas
JIM RYUN, Kansas
MAC COLLINS, Georgia
ERNIE FLETCHER, Kentucky
GARY G. MILLER, California
PAT TOOMEY, Pennsylvania
WES WATKINS, Oklahoma
DOC HASTINGS, Washington
JOHN T. DOOLITTLE, California
ROB PORTMAN, Ohio
RAY LAHOOD, Illinois
KAY GRANGER, Texas
EDWARD SCHROCK, Virginia
JOHN CULBERSON, Texas
HENRY E. BROWN, Jr., South Carolina
ANDER CRENSHAW, Florida
ADAM PUTNAM, Florida
MARK KIRK, Illinois

JOHN M. SPRATT, Jr., South Carolina,
Ranking Minority Member
JIM MCDERMOTT, Washington
BENNIE G. THOMPSON, Mississippi
KEN BENTSEN, Texas
JIM DAVIS, Florida
EVA M. CLAYTON, North Carolina
DAVID E. PRICE, North Carolina
GERALD D. KLECZKA, Wisconsin
BOB CLEMENT, Tennessee
JAMES P. MORAN, Virginia
DARLENE HOOLEY, Oregon
TAMMY BALDWIN, Wisconsin
CAROLYN MCCARTHY, New York
DENNIS MOORE, Kansas
MICHAEL E. CAPUANO, Massachusetts
MICHAEL M. HONDA, California
JOSEPH M. HOEFFEL III, Pennsylvania
RUSH D. HOLT, New Jersey
JIM MATHESON, Utah

PROFESSIONAL STAFF

RICH MEADE, *Chief of Staff*
THOMAS S. KAHN, *Minority Staff Director and Chief Counsel*

CONTENTS

CONGRESSIONAL BUDGET OFFICE PROJECTIONS

WEDNESDAY, JANUARY 23, 2002

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

The committee met, pursuant to call, at 2:34 p.m. in room 2318, Rayburn House Office Building, Hon. Jim Nussle (chairman of the committee) presiding.

Members present: Representatives Nussle, Sununu, Bass, Gutknecht, Thornberry, Ryun, Toomey, Hastings, Schrock, Brown, Crenshaw, Putnam, Kirk, Spratt, McDermott, Bentsen, Davis, Clayton, Price, Clement, Moran, Moore, Capuano, Hoeffel, Holt, and Matheson.

Chairman NUSSLE. The committee on the budget will come to order. First of all, out of order for just a moment just by way of explanation, we are in the Science Committee. We appreciate the Committee on Science for lending us their room for the time being. Our committee hearing room continues to proceed with renovations. It should be completed, hopefully soon, so that the next hearings that we hold, we will be back in home field advantage. We look forward to that, but we appreciate the Science Committee for the use of their room. Today's hearing is intended to review the budget and economic projections for the coming decade as estimated by the Congressional Budget Office. The projections, which will be published next week in CBO's report of the budget and economic outlook fiscal years 2003 to 2012, will serve as a backdrop or context, as it typically does, for Congress's budgetary decisions in the coming year.

The CBO figures also provide an assessment on why large budget surpluses projected a year ago have declined. This accounting is expected to show that most of the surplus reduction in fiscal year 2003 and over the next 10 years as a result of terrorist attacks on the United States; the war against terrorism being waged overseas; and the economic recession that we find ourselves in. Such conclusions would be contrary to the views of administration critics who have been repeatedly trying to blame the surplus decline on tax reduction measured by the enactment of the tax bill last year. The hearing's witness today will be Dan Crippen, the director of the Congressional Budget Office, who will make the report on these findings.

Before I turn it over to my friend and colleague, Mr. Spratt, let me just make a couple of opening comments that I think need to be made at this particular juncture. I don't think there is any speech I have heard in the last couple of months that didn't begin with "on September 11, the world changed." For me, I have a simple question and challenge for my colleagues: Will those changes manage us or will we manage those changes? I believe it is incumbent on the United States Congress, the President of the United States and particularly—using the leadership role of the Budget Committee—to begin to manage those changes in the budget that we will begin to discuss and review is the first step in making some of those important management decisions for the changes that we all know have to happen.

After four straight balanced budgets and half a trillion dollars worth of debt reduction, we find ourselves in a deficit. Why? Well, there are those who obviously cheerily blame tax relief from last year and, in fact, have already put forward ideas on raising taxes as a way to try and get ourselves out of the situation that we find ourselves in. But it wasn't taxes that got us here, and raising taxes isn't going to get us out of the problem that we find ourselves in, and so let me be very clear from the outset. This budget committee will not raise taxes as a management plan to deal with the fiscal situation that we find ourselves in. We will do quite a bit over the next number of years, but raising taxes is not an option, particularly when we are in the middle of a recession.

In order for us to deal with the challenges, we have got to fund America's priorities first. That has to be job one of this budget, and obviously, the priorities have changed since last September. We have a war, we have a recession, and we have a national emergency to deal with. The President, in his February address to the Congress, said that there were only three individual reasons why the United States Federal Government might have to go into deficit. Number one was a war. Number two, separately was a recession, and number three, separately, was the national emergency. Because of September 11—a deepening recession that now most experts suggested started at least last spring, if not before—we now find ourselves dealing with all three at the exact same time.

Now, I know for many reasons it will be very interesting, particularly in a political year, to try and blame policies of tax relief, when taxes were the highest of any time since World War II, to try and blame tax relief as a way of demonstrating how we got into this situation. But as the report from the Congressional Budget Office suggests, that is just simply not the case. I think probably one of the best ways to demonstrate that is by looking at where the surplus went. So let us look at a chart, see how the Science Committee does on technology here for us. So far, so good, I guess, on a chart that can help depict exactly where the surplus went according to what the Congressional Budget Office is telling us. Just in case it doesn't come up, we use the—oh, here we go. And, boy, it looks like a headline news. Surplus estimates drop sharply. Boy, that isn't news. Everyone has known that has been coming. Mr. Spratt has been telling us that since how long ago?

Mr. SPRATT. Since you passed the tax cut.

Chairman NUSSLE. Since we are in the Science Committee, let me state very clearly, it didn't take a rocket scientist to come up with that deduction, because we planned on that. We wanted that tax cut. We felt it was important to give people back their money, because in a recession, when you are trying to deal with economic changes, letting people spend their own money, not letting the government do that for them was job one, and that is exactly why we passed the budget in the tax relief package from last year. As you see, that is just a small part of the change. According to the Congressional Budget Office, 1.6, almost equal to the tax cut relief over the 10 years, came from the economy, .8 from spending, which, let me remind my colleagues, we almost all cheerfully voted for in the packages that were passed this fall. We have a remaining surplus over this particular time. So, yes, the surplus has—and the surplus estimates over the 10 years have dropped sharply. Some of it was deliberate, and deliberate at a time when we needed a shot in the arm for the economy, and the rest came from the economy and spending that we all, in a bipartisan way, put forward.

In order to meet the challenges from the war, the recession and the emergency, we need to focus on coming up with a budget to deal with this. We are going to disagree today. I have no doubt that there will be those who suggest that tax cuts is what got us here and tax cuts alone. Tax increases is not how we are going to get out of it, but we do need a plan. We have put forward, I think, a very positive and constructive plan from the House of Representatives in order to deal with this, and let me just review what we have done.

First of all, we had a budget that prioritized in a number of different positive ways what America's priorities should be. Second, we passed protrade negotiation authority so that we could begin to improve, renegotiate and begin to negotiate an open trade around the country to create jobs around the world. Next was an energy plan so that we could break the bonds of 56, 57 percent dependency on foreign oil—much of it coming from the Middle East—and recognizing that we will continue to be entangled in the Middle East as long as we have that dependency.

And last but certainly not least, an economic stimulus package that said that we need to deal with dislocated workers, we needed to cut taxes for the middle class, we needed to provide benefits to workers, and we also needed to make sure that those who did not receive the benefits from the first tax relief package received some benefits in this plan. We passed it twice, and we are waiting for action; we passed an emergency plan and we are waiting for action; we passed a stimulus plan and we are waiting for action; we passed protrade negotiative authority and we are waiting for action.

Where does that action need to come? From the Senate. We are waiting. America is waiting. We have a plan to get out of this mess. We know we are in a mess. America knows we are in a mess. We didn't put ourselves in that mess. We were put there by Osama bin Laden and the number of terrorists that we are dealing with right now, and we will deal with them, and we will reprioritize our budget to deal with them, even as we have stated in our balanced budget amendments in the past, and as the President has stated in his financial address to the Congress this past year, even if it means having to borrow for a short period of time—and I emphasize the word "short"—in order to deal with those problems.

So we wait for action from the United States Senate. My concern, in watching the process thus far, is that as we look at the budget process, I am concerned whether or not we can actually achieve a budget through the Congress this year, and let me be very clear about my intentions as the chairman and what I will be advocating to the House of Representatives as we move forward. We are going to be on time. We are going to hold the hearings. We are going to write the document. We are going to accept the President's recommendations, and we are going to draft a budget. And we are going to have it done on time the way we did last year. We are going to be prepared to negotiate and to discuss and to prioritize with our colleagues in the Senate. But we will continue, as we have this fall, to move in a positive direction forward for our constituents and for America if, in fact, the Senate fails to act. We will continue to move forward. We will not wait. We will not stop. We will not falter. We will not allow the gridlock of five or six acting minority leaders in the Senate to stop our progress in the House of Representatives. And that you can be assured of.

We realize that there will be a number of negotiations, as there has to be, this year on priorities. We know that we are not going to have commonality, even within our own caucuses, on exactly what needs to be done, but we have to start moving forward, we have to start having the votes. The House has had the votes. The Senate needs to have those votes, and we are going to continue to apply pressure so that America can move successfully forward to meet the challenge that has been presented to us by the last number of months.

It is not going to be easy. We all know that. We have been home talking to our constituents. You think this budget is hard to balance, try balancing a budget when you don't have a job. Try and figure out how you are going to pay for college when you are not making any money and you are trying to work off of unemployment. Forget about it. This budget is important, as important as any other job that we have to meet this year, but this is still about people, and making sure that they have got the resources around their kitchen table to deal with their home budget, their farm budget or their small business budget. But today's focus is on where we are, and the good news is that we have got a projection for where we are today. The challenge, of course, as we always talk about with our good friend, Mr. Crippen, is that the numbers are almost never precise.

Mr. CRIPPEN. That was kind.

Chairman NUSSLE. And it calls upon all of us to use our best judgment as we move forward, but we appreciate the advice that CBO is going to be giving us today.

With that, let me turn it over to my friend and colleague, Mr. Spratt, for any opening comments he would like to make, and before he does that, all members—I ask unanimous consent that all members be allowed to put in a statement in the record at this point.

Mr. Spratt.

Mr. SPRATT. Thank you, Mr. Chairman.

Chairman, it was just a month ago that President Bush said that his administration had—and quoting—brought sorely needed fiscal discipline to Washington. Today the Congressional Budget Office reports that $4 trillion of the $5.6 trillion projected surplus, $4 trillion, has disappeared in a year. Last January, CBO projected a surplus of $359 billion for fiscal year 2003. This January, today, CBO projects a deficit of $14 billion, a wing from a surplus of $359 billion to a deficit of $14 billion, a reversal of almost $400 billion in 1 year. Surely the biggest budgetary reversal in the history of this country. If this is fiscal discipline, it has an odd bottom line.

The chairman said it. I repeat it. War and recession and tax cuts have overtaken the budget, and I think that adhering to this budget, the budget that was passed by resolution last year in the face of this report, isn't fiscal discipline. It would be fiscal denial. I don't want to be in the role of saying I told you so, but a lot of the things that are laid out in this report and will be testified to by Dr. Crippen today confirm our concerns that we have expressed about the Republican budget for an entire year. First of all, the fragility of these surpluses. In 1 year, $4 trillion of the unified surplus has vanished, and the on-budget surplus has become an on-budget deficit. That is a fact. The on-budget surplus has become an on-budget deficit.

Now, that is important. Dr. Crippen will talk consistently about the total surplus, the total deficit, but the number that matters most to us, if we abide by the law, is the on-budget surplus, the surplus in our budget exclusive of Social Security. Why? When I was here 10, 12 years ago, we all voted for a law that took Social Security off-budget and made it an independent account. Secondly, if we want to abide by our promise as represented by the lock box that we touted so much over the last 2 years, not to borrow and spend the Social Security surplus, but to save the surplus and to use it only for Social Security purposes or for buying up outstanding debt held by the public, then the number that we must target and look at and be concerned about is the on-budget surplus number, and as I said, for all practical purposes, for every year throughout this forecast, the on-budget surplus is gone.

So the problem is not so much where we are. We can't do much about that. The problem is where we are going. As you look out over time, the horizon and over the horizon, particularly after 2008, when the baby boomers retire and begin to draw their Social Security benefits.

Now, I am not here to tell you that the tax cut is the sole and only cause of the problem. It is not. We advocated a smaller tax cut ourselves last year, about half the size that was actually passed. We certainly aren't for raising taxes now in the middle of a recession. I want to make that clear. We are not here to claim that the tax cut is the only cause of the vanishing surplus. But it is one of the causes, as the chart that is now before you shows. You can't see the colors clearly on this. Or at least I can't. I am red, green color-blind but——

Chairman NUSSLE. I will interpret it for you.

Mr. SPRATT. You can see that the surplus was a major factor last year. That is because of the tax rebate. It is a minor factor this year and next year, but over time each year it stairsteps upward. In 2010, it drops down again, but that is for a reason that we all know won't be applicable. This tax bill—in order to shoehorn as much as possible into the limits of a $1.35 trillion allocation, has a very improbable feature to it, a sunset. All of the tax provisions that implement steadily over time are suddenly repealed in the year 2010. Now, that is not going to happen. Politically, it is not going to happen. I know it, whether I am here or not, in 2010, it is not going to happen, and if you assume that it doesn't happen, that the sunset won't be repealed, then those stairsteps keep going upward, and the surplus for the 10-year frame of time, assuming the repeal of the repealer, the recession of the sunset, constitutes more than 50 percent of the cause for the disappearance of the unified surplus.

This makes a mockery of all of our rhetoric about a lock box, because what we are going to be doing over the next number of years, probably for the full time frame that is forecast here, is dipping into Social Security again. First of all, we are going to spend all of Medicare. Now, Mr. Chairman, I know that you made an earnest statement last year when Mr. Daniel was here, and he would not disavow the intent to spend some of the Medicare trust fund. You proposed spending some of the Medicare trust fund, building up over the next 10 years, for Medicare prescription drugs. Well, let me tell you, we are going to spend all of it and not for Medicare, not for prescription drugs. We are going to spend it to run the basic operations of the United States Government, all of it. And we are probably going to dip into Social Security to at least half the trust fund. I don't think that is a radical proposal at all.

So after all of this earnest talk about this lock box—and it was—the core idea of which was a good idea, that we would begin to use the Social Security surpluses as a mechanism for increasing net national saving, and we would lay the basis on a bipartisan basis for the first step toward this long run solvency of Social Security is out the window, unless this budget is significantly changed.

One small item. Over the last 3 or 4 years, we have had a dividend that has barely been seen, but it has been realized as we have been allocating and appropriating out of our budget, and that is the decline in net national interest payments by 20, $30 billion for a period of 3 or 4 years, they have staircased downward. As a result of the consequences of this budget built into this budget, we are going to see an increase of over a trillion dollars, in the interest payments of this Federal Government on its debt over this period of time.

Now, let me say that the numbers we are talking about are a current services, current policy baseline. They don't include an awful lot of things that are in the pipeline on the agenda and are likely to be beyond this year or next year or in the very near future. For example, Mr. Chairman, the farm bill, that is not included in this baseline. We don't have anything for natural disasters, not fully affected in this baseline. We don't have a full increase in defense. I heard today that the defense increase will be at least $30 billion, maybe $40 billion, for the Department of Defense alone. This assumes less than half of that amount.

This is a current services baseline before we have done anything additional in the way of spending initiatives or anything additional in the way of additional tax cuts. And they are coming, too. You all know the expiring tax provisions. You all know we have got a huge problem with the individual alternative minimum tax that we will have to fix sooner or later, and you have got, as I said, the repealer at the tail end of your tax cut, which itself will be rescinded before it is all over with, and that will add $373 billion or take away $373 billion from the bottom line here.

So what we are looking at here is as good as it gets, and as a result, what we are going to see is the on-budget surplus, that most important number of all, the one that we should really be targeting, we are going to see it decline from $3.1 trillion just last January. It already dropped $846 billion by August. As a result of what we are baselining—what we have here today—there you go. Well, there it is right there, in simple language, $3.1 to $742 billion deficit over that period of time. This is a dire situation, and I hope, Mr. Chairman, that we can do our business on time, but I would like to think that we could somehow come to the table. Everybody would come to the table, and everything would be on the table, because this budget needs major work, or we are going to be faced with dire consequences for years and years to come.

Dr. Crippen, welcome, and I look forward to your testimony.

Chairman NUSSLE. Welcome CBO Director Dan Crippen again to the Budget Committee. We welcome you, look forward to your testimony. You may proceed. Your entire report will be made part of the record and your testimony and you may proceed as you see fit. Welcome.

STATEMENT OF DAN L. CRIPPEN, DIRECTOR, CONGRESSIONAL BUDGET OFFICE

Mr. CRIPPEN. I am gratified to be here for a number of reasons. I am also——

Chairman NUSSLE. You may need to push a button up there. I am not sure.

Mr. CRIPPEN. Did that do anything?

Chairman NUSSLE. No.

Mr. CRIPPEN. How's that?

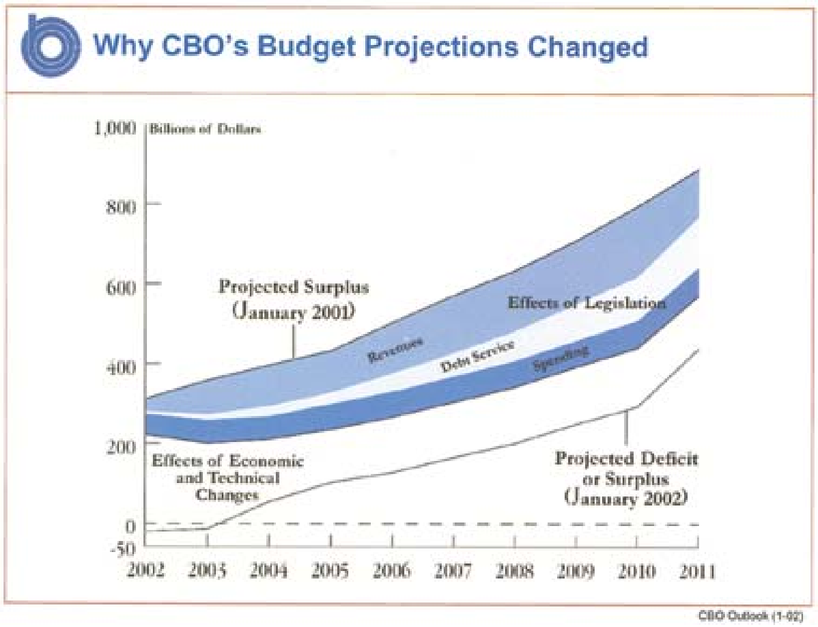
Chairman NUSSLE. There you go. Thank you.

Mr. CRIPPEN. I started to send an appreciative comment also on where I am sitting. You could have put me underneath that thing, which I think has a cable and a winch, and you could—anyway.

Mr. Chairman, Congressman Spratt, and other members of the committee, I appreciate the opportunity to represent CBO this afternoon, presenting our current assessment of the economic and budget outlook. I might say, as I did this morning, that I am here to reveal the worst-kept secret in Washington. Our surplus estimates of a year ago have diminished. As many of your colleagues said this morning as well, what a difference a year makes. I have often heard that a year in politics is an eternity, but it turns out that a year in economics is also a long time.

As you are all aware, the results we present today, as Mr. Spratt just said, are our current best estimate for the economy over the next 10 years and the associated budget outlook, but with no policy changes. No increase in spending for the war on terrorism or for homeland defense, no additional spending for farm programs, no additional reduction in taxes for stimulus beyond that under current law. No renewal of expiring tax provisions.

These first two charts attempt to illustrate graphically and numerically what has happened to the projected surpluses and why our projections have changed (see figures 1 and 2). Now, the gross numbers here both of you have already addressed. The outlook for surpluses over the next 10 years has gone from $5.6 trillion to $1.6 trillion over the same period, obviously a reduction of $4 trillion. The primary causes of that decline, the diminished performance of the economy and the passage of legislation, vary in importance over the 10-year period.



In the near term, the biggest change since last January is clearly the economy. Instead of the 3.4 percent real growth in gross domestic product (GDP) we forecast a year ago—which was at the time similar to most other forecasts—we now expect GDP to grow less than 1 percent this year. As a result of that change in economic circumstances and the mostly related technical adjustments that go along with it, the balance for our current fiscal year will be something like $240 billion less than we forecast a year ago.

Legislation enacted since last January will further reduce balances this year by nearly $90 billion—not counting debt service—one-third of which is in reduced revenues and two-thirds in increased outlays. Combined, those changes amount to a swing of over $300 billion, and they alter our forecast from roughly a $300 billion surplus to a $20 billion deficit. A similar pattern exists for the budget year 2003, with a resultant small deficit of $14 billion. By 2004, under current policies, we forecast the emergence of unified surpluses, with on-budget surpluses developing again near the end of the decade.

Why CBO's Budget Projections Changed
(In billions of dollars)

	2002	2002-2011
January 2001 Projection	**313**	**5,610**
Legislative Changes		
Tax Law	-38	-1,275
Defense Appropriations	-33	-301
Nondefense Appropriations	-11	-249
Debt Service and Other Costs	-9	-595
Subtotal	-91	-2,420
Economic Changes	-148	-929
Technical Changes	-94	-660
Total Changes	-333	-4,008
January 2002 Projection	**-21**	**1,602**

CBO Outlook (1/02)

Our projection of changes in the second half of the next 10 years show somewhat the reverse pattern. Changes in legislation have a more important impact than changes in the economy. By 2011, changes in law since last January directly reduce the surplus that we estimated last January by just under $200 billion, $120 billion from revenue and $63 billion from spending. Changes in the economic outlook and technical changes account for an additional $124 billion.

Over the 10 year period from 2002 through 2011, then, changes account for 40 percent of the diminution in surpluses, whereas legislative changes account for 60 percent.

This recession, Mr. Chairman, and its effects on the budget have been unusual in several respects. First, the downturn was precipitated not by the usual circumstances of demand outstripping supply, causing inflation and a subsequent tightening of monetary policy. Rather, this time a precipitous drop-off in capital spending and inventories by corporations of all types, but especially for IT products, caused about three-quarters of the decline in GDP growth. Although the increase in consumer spending slowed, it remained a source of strength through much of last year.

Second, what has been characterized as an over-investment was accompanied by a marked decline in equity markets, especially for high-tech stocks, which, in turn, meant fewer capital gains, slowdowns in gains realization, and therefore in capital gains revenues.

Third, the attacks of September 11 probably exacerbated the recession we were already in, and while most of the initial impact seems to have worn off, at least some industries, such as airlines, have not recovered. The possibility of future terrorist attacks has increased uncertainty and led to a significant and growing level of expenditure on security.

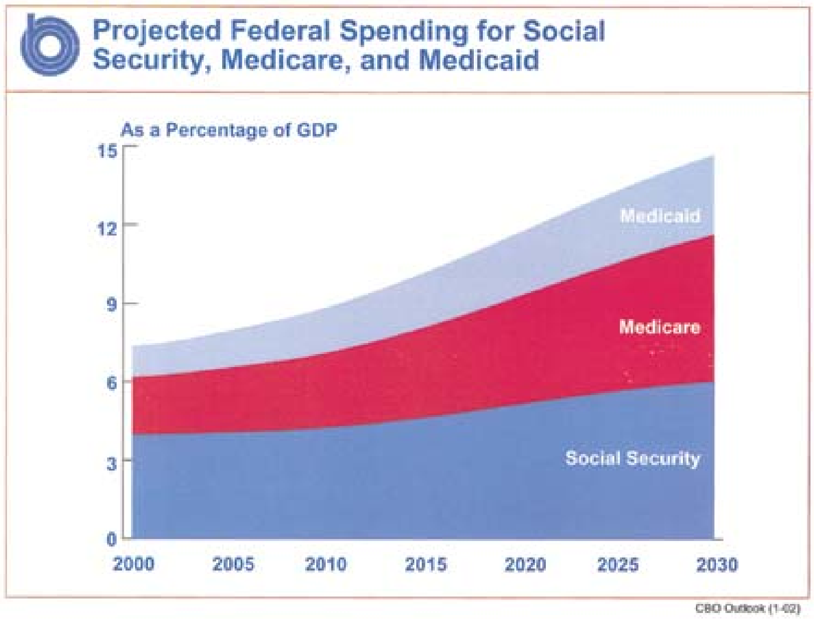
Fourth, our current economic projections alone would not have reduced revenues as much as was implied by this overall forecast. Revenue collections at the moment are running lower than expected, even given the current level of anemic growth. There are some phenomena here we simply don't fully understand. They may be temporary or permanent, but they are permanently built into this forecast.

Finally, while not directly related to the downturn, the Bureau of Economic Analysis has simultaneously and substantially reduced its estimates of for the previous three years, which, in turn, lowered the base and the expected growth of the economy in the future.

Given the nature of this recession, that is, the dearth of capital spending, the economy will likely be slow to recover even after it bottoms out. Only when consumption and inventory needs to strain current capacity, will it be profitable to invest again in capital stock, and only then will growth in the economy resume its 3 percent potential rate.

Mr. Chairman, I am sure the committee has many questions about this forecast and its implications for policy, and I don't want to try to anticipate them in my statement. Before I relinquish the floor, I feel compelled once again—as I normally do—to remind everyone that the 10-year period in our baseline will only begin to touch on the era of what is likely to be the largest actual real, not merely projected, fiscal swing in our history.

The retirement of my generation will double the number of retirees receiving Federal benefits, while the workforce that must support us and must pay our benefits will grow only nominally. What this means, I believe, is found in this poor chart I drag around with me everywhere I go, mainly that these three programs—Social Security, Medicare and Medicaid—will consume more than twice as much of the economy as is presently the case (see figure 3).

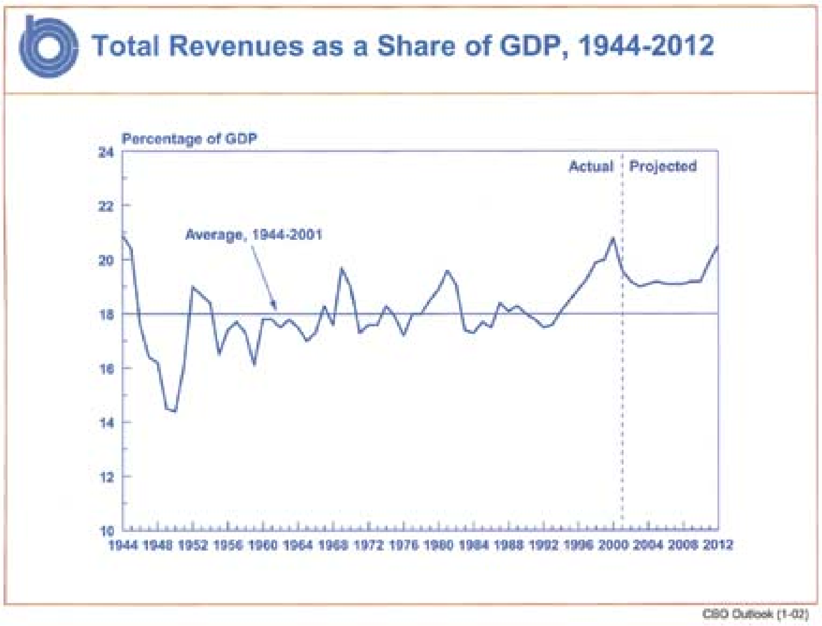


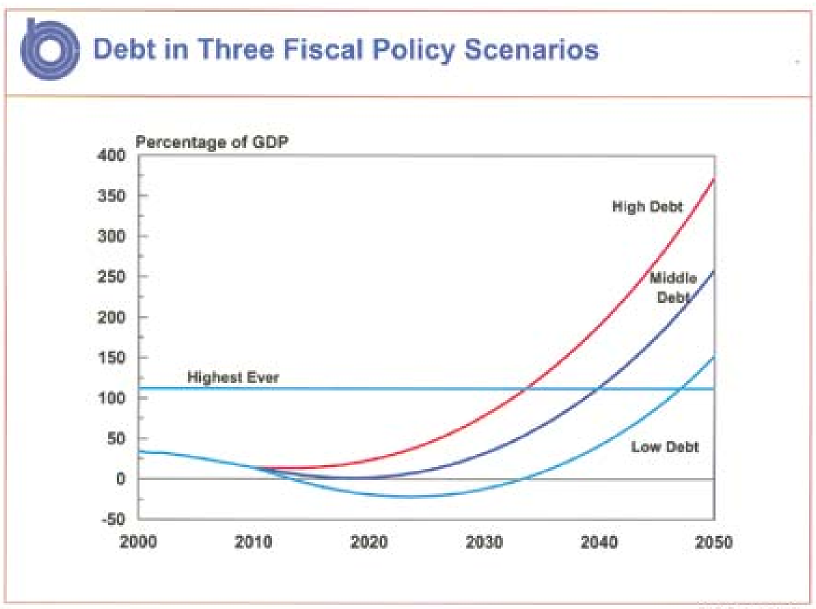
There are a number of important implications to take away from this graph. First, there are really only two moving parts to the picture. Spending on the elderly, which is the numerator, and the size of the economy, which is the denominator. While the operation of the trust funds is not wholly irrelevant, the most important thing we can do for our children and grandchildren is to grow the economy, not the trust funds, and perhaps accept lower benefits for ourselves.

When the day comes to collect my Social Security, it matters less how the cash that I will spend is generated, but how much of what my kids are producing I will demand they hand over to me. Whether it is financed by taxes on them, or providing less of other government programs for them, it will be my kids nonetheless, who pays my benefit.

Finally, this growing wedge will consume nearly the resources we now expend for all Federal programs. That means, quite simply, that other programs will need to be cut, taxes raised, or debt issued to the tune of nearly 10 percent of GDP.

As the next chart illustrates, since World War II the average Federal tax take has been 18 percent of GDP (see figure 4). Even with last year's tax cut, revenues will remain well above that average. Put more starkly, the extremes here are quite clear. One of them will be that we would have to raise taxes to about 30 percent of GDP to pay for benefits. Another way to look at this, and I don't think you have an electronic version of this last chart, is the debt levels that might be required to sustain the current Federal budget, along with the increases in Social Security, Medicare and Medicaid (see figure 5).





Almost any fiscal scenario one could envision, which is an increase or decrease from the baseline on debt, will, before too long, become unsustainable. The highest point ever, which was reached in World War II, is the horizontal line of a little more than 100 percent of GDP—or where Japan finds itself now—but it won't take long before we would exceed that highest ever level if we were to issue debt.

The result here, if you look at extreme solutions, is that we will have to increase borrowing by a very large and likely unsustainable amount, raise taxes to 30 percent of GDP from 19 percent of GDP currently, or eliminate most of the rest of the government as we know it. None of those are very palatable. Some combination of them is likely, but we need to take action as soon as we can to address what we only see now as the tip of the proverbial iceberg. With that, Mr. Chairman, I will retire.

Chairman NUSSLE. Not yet. You can stop, but you don't need to retire yet.

[The prepared statement of Dan L. Crippen follows:]

PREPARED STATEMENT OF DAN L. CRIPPEN, DIRECTOR, THE CONGRESSIONAL BUDGET OFFICE

Mr. Chairman, Congressman Spratt, and members of the committee, I am pleased to be here today to discuss the current outlook for the budget and the economy. The Congressional Budget Office (CBO) will release its report on that topic, The Budget and Economic Outlook: Fiscal years 2003–2012, on January 31. My testimony today will summarize that report.

The economic recession and recent laws have combined to sharply reduce the budget surpluses projected a year ago. In January 2001, CBO projected that under the laws and policies then in force, the Federal Government would run surpluses in fiscal years 2002 through 2011 totaling $5.6 trillion. [1] In CBO's new projections, that cumulative surplus has fallen to $1.6 trillion—a drop of $4 trillion (see Table 1 on page 7).

About 60 percent of that decline results from legislation—the tax cuts enacted in June and additional discretionary spending—and from its effect on the cost of paying interest on the Federal debt. Changes in the economic outlook and various technical revisions since last January account for the other 40 percent of that decline.

For both 2002 and 2003, CBO now projects that, instead of surpluses, the total budget will show small deficits, if current policies remain the same and the economy follows the path that CBO is forecasting. In 2001, by contrast, the Federal Government recorded a surplus of $127 billion (see Table 2).

The deficit projected for this year—$21 billion—represents a change of more than $300 billion from last January's projection. Over 70 percent of that reduction results from the weak economy and related technical factors, which have considerably lowered the revenues expected for this year and next.

For the current 10-year projection period, 2003 through 2012, CBO estimates a total surplus of nearly $2.3 trillion. However, almost half of that total comes from the surpluses projected for 2011 and 2012—the last 2 years of the projection period and thus the most uncertain. The surpluses for those years also reflect the scheduled expiration in December 2010 of the tax cuts enacted last June.

In CBO's new baseline, the off-budget accounts (which reflect the spending and revenues of Social Security and the Postal Service) run surpluses throughout the projection period. In the on-budget accounts, by contrast, surpluses do not reemerge until 2010.

CBO's baseline projections are intended to serve as a neutral benchmark against which to measure the effects of possible changes in tax and spending policies. They are constructed according to rules set forth in law and long-standing practices and are designed to project Federal revenues and spending under the assumption that current laws and policies remain unchanged. Thus, these projections will almost certainly differ from actual budget totals: the economy may not follow the path that CBO projects, and lawmakers are likely to alter the nation's tax and spending policies. Therefore, CBO's baseline should be viewed not as a forecast or prediction of future budgetary outcomes but simply as the agency's best judgment of how the economy and other factors will affect Federal revenues and spending under current law.

---

[1] That projection appeared in Congressional Budget Office, "The Budget and Economic Outlook: Fiscal Years 2002–2011" (January 2001).

THE BUDGET OUTLOOK

If current policies remain in place, CBO projects, the budget will be in deficit for the next 2 years. Those deficits are expected to be quite small, amounting to only 0.2 percent of the nation's gross domestic product (GDP) in 2002 and 0.1 percent of GDP in 2003. After that, surpluses are projected to reemerge and gradually increase.

For the 5 years from 2003 through 2007, CBO projects a cumulative surplus of $437 billion. That figure represents off-budget surpluses totaling more than $1 trillion offset by on-budget deficits that add up to $617 billion. For the 10-year period through 2012, the total budget surplus under current policies is projected to approach $2.3 trillion. Again, that amount is made up of surpluses in Social Security ($2.5 trillion) offset by a cumulative on-budget deficit ($242 billion). Without the scheduled expiration of tax-cut provisions in 2010, the total 10-year budget surplus would fall to $1.6 trillion.

The total surplus is projected to equal 1 percent of GDP by 2006 and grow to 3.7 percent of GDP by 2012. Estimates of large surpluses should be viewed cautiously, however, because future economic developments and estimating inaccuracies could change the outlook substantially. In addition, future legislative actions are almost certain to alter the budgetary picture.

Changes in the Past Year

As an illustration of how quickly the budget outlook can change, CBO's projection of the cumulative surplus for 2002 through 2011 has plunged by $4 trillion in just 1 year (see Table 1).[2] Some $2.4 trillion of that drop can be attributed to legislative actions. The legislation with the largest effect was the Economic Growth and Tax Relief Reconciliation Act of 2001, enacted in June. That law is estimated to reduce surpluses by nearly $1.3 trillion over 10 years (not including associated debt-service costs).

Additional discretionary spending since last January accounts for another $550 billion reduction in the projected surplus for the 2002–2011 period. That amount stems from both regular and supplemental appropriations. CBO's January 2001 baseline assumed that discretionary budget authority for 2002 would total $665 billion.[3] The actual amount appropriated for 2002 in the 13 regular appropriation acts totaled $691 billion. In addition, the Congress and the President enacted $20 billion in supplemental budget authority in December as part of their response to the terrorist attacks of September 11—thereby generating a total of $711 billion in budget authority for 2002, $45 billion more than CBO assumed last January.

Under the provisions of the Balanced Budget and Emergency Deficit Control Act of 1985, CBO's baseline assumes that annual appropriations for discretionary programs continue at their current level, increasing only by the rates of inflation projected for each year. As a result of the appropriations enacted for 2002, projections of discretionary spending in the current baseline begin at a level that is $45 billion higher than a year ago.

Furthermore, two supplemental appropriation laws enacted in fiscal year 2001—one for defense personnel and readiness programs and another in immediate response to the attacks of September 11—will generate outlays totaling around $25 billion in 2002 and beyond. However, budget authority from actions in 2001 is not carried forward into the baseline projections for future years because those appropriations occurred before the current year.

Overall, legislated reductions in revenues, additional discretionary spending, and other laws with smaller budgetary effects have reduced projected surpluses—and thereby increased the government's borrowing needs—by $1,858 billion for 2002 through 2011. That increased borrowing is projected to result in an extra $562 billion in net interest costs over the 10-year period.

Changes in the economic outlook since January 2001 account for another $929 billion decline in the 10-year surplus. About three-quarters of that total reflects lower revenue projections, mostly resulting from the substantially weaker economic growth expected in the near term and the slightly lower average growth rates projected for the following several years. Much of the rest of the decline attributable to the economic outlook represents additional debt-service costs resulting from the reduction in anticipated revenues.

---

[2] About 45 percent of that reduction results from changes made since CBO issued its updated "Budget and Economic Outlook" in August. The drop since August totals $1.8 trillion and is attributed, in relatively equal measures, to legislative, economic, and technical changes.

[3] That figure was calculated by assuming that the amount appropriated for the base year of 2001 would grow at specified rates of inflation.

Technical changes—those not driven by new legislation or by changes in CBO's economic forecast—have reduced the projected 10-year surplus by a total of $660 billion since last January. As with the economic changes, revenues account for over 75 percent of the technical changes, and debt service accounts for much of the rest. The technical changes to revenues stem primarily from revised projections of capital gains realizations and adjustments for lower-than-expected tax collections in recent months.

Homeland Security

Since the attacks of September 11, Federal agencies, State and local governments, and the private sector have perceived a heightened threat to the United States and a need to commit more resources to homeland security. On the Federal level, legislation following the attacks increased the budget authority provided for such security from $17 billion in 2001 to $22 billion for 2002. What level of resources to commit to homeland security will undoubtedly be a key issue as the Congress and the President make decisions about spending and other policies this year.

The Outlook for Federal Debt

In the January 2001 Budget and Economic Outlook, CBO estimated that Federal debt held by the public would reach a level in 2006 that would allow the Treasury to retire all of the debt available for redemption. At that time, CBO also projected that the statutory ceiling on all Federal debt (which includes debt held by government accounts) would not be reached until 2009. Now, CBO estimates that debt held by the public will not be fully redeemed within the 10-year projection period and that the current debt ceiling will be reached in the next few months. Nevertheless, if the surpluses projected in the current baseline materialize, debt held by the public will fall to about 15 percent of GDP in 2010—its lowest level since 1917.

THE ECONOMIC OUTLOOK

In CBO's opinion, the most likely path for the economy is a mild recession that may already have reached its nadir. CBO expects the annual growth rate of real (inflation-adjusted) GDP to accelerate from −0.2 percent in 2001 (measured from the fourth quarter of calendar year 2000 to the fourth quarter of 2001) to 2.5 percent in 2002 and to accelerate further to 4.3 percent in 2003.

CBO believes, some unusual features of the current recession will cause it to be mild. Chief among those features are the rapidity of policymakers' responses, the moderating behavior of prices, and an early reduction in businesses' inventories. In less than 1 year, the Federal Reserve has cut the Federal funds rate 11 times—from 6.5 percent to 1.75 percent. Also, the tax cuts enacted in June prevented consumption from slowing more than it might have otherwise, and additional Federal spending in response to the terrorist attacks will boost GDP in 2002. Lower prices for oil and natural gas and mild price increases for other items are supporting consumption by boosting real disposable income. Furthermore, businesses began to reduce inventories earlier in this recession than they did in past downturns, which may mean that fewer cuts in inventories remain than at this stage of the typical recession.

CBO projects that weak demand in the short run will translate into weak employment, pushing the unemployment rate higher for the next several quarters while restraining inflation. With growth of real GDP near zero early this year, the unemployment rate is expected to increase to 6.1 percent in calendar year 2002 from 4.8 percent last year (see Table 3). The rate of inflation faced by consumers is forecast to fall from 2.9 percent last year to 1.8 percent in 2002. Lower oil prices account for most of the projected decline in inflation, although the recession also plays a role. As oil prices stabilize in CBO's forecast, inflation bounces back to 2.5 percent in 2003.

Looking out through 2012, CBO expects the growth of real GDP to average 3.1 percent during the 2002–2012 period—roughly the same as it projected last January for the 2002–2011 period. Nonetheless, the level of real GDP is lower each year than in last January's projections, primarily because actual GDP ended up much lower in 2001 than CBO had expected a year ago.

UNCERTAINTY OF THE PROJECTIONS

CBO's baseline projections represent the midrange of possible outcomes based on past and current trends and the assumption that current policies do not change. But considerable uncertainty surrounds those projections for two reasons. First, future legislation is likely to alter the paths of Federal spending and revenues. CBO does not predict legislation—indeed, any attempt to incorporate future legislative changes would undermine the usefulness of the baseline as a benchmark against which to measure the effects of such changes. Second, the U.S. economy and the Federal budget are highly complex and are affected by many economic and technical factors that are difficult to predict. As a result, actual budgetary outcomes will almost certainly differ from CBO's baseline projections.

In view of such uncertainty, the outlook for the budget can best be described as a fan of probabilities around the point estimates presented as CBO's baseline (see Figure 1). Not surprisingly, those probabilities widen as the projection period extends. As the fan chart makes clear, projections that are quite different from the baseline have a significant probability of coming to pass.

THE LONG-TERM OUTLOOK

Despite the sizable surpluses projected for the later years of CBO's 10-year budget outlook, long-term pressures on spending loom just over the horizon. Those pressures result from the aging of the U.S. population (large numbers of baby boomers will start becoming eligible for Social Security retirement benefits in 2008 and for Medicare in 2011), from increased life spans, and from rising costs for Federal health care programs. According to midrange estimates, if current policies continue, spending on Social Security, Medicare, and Medicaid combined will nearly double by 2030, to almost 15 percent of GDP.

Taking action sooner rather than later to address long-term budgetary pressures can make a significant difference. In particular, policies that encourage economic growth—such as running budget surpluses to boost national saving and investment, enacting tax and regulatory policies that encourage work and saving, and focusing more government spending on investment rather than on current consumption—can help by increasing the total amount of resources available for all uses.

TABLE 1.—CHANGES IN CBO'S BASELINE PROJECTIONS OF THE SURPLUS SINCE JANUARY 2001

[In billions of dollars]

	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	Total, 2002–2006	Total, 2002–2011
Total Surplus as Projected in January 2001	313	359	397	433	505	573	635	710	796	889	2,007	5,610
Changes:												
Legislative:												
Tax act[1]	−38	−91	−108	−107	−135	−152	−160	−168	−187	−130	−479	−1,275
Discretionary spending	−44	−49	−52	−54	−56	−57	−58	−59	−60	−61	−255	−550
Other	−4	−6	−5	−3	−4	−2	−2	−2	−2	−2	−23	−33
Debt service[2]	−5	−12	−22	−32	−44	−57	−72	−88	−106	−124	−114	−562
Subtotal	−91	−158	−186	−197	−238	−268	−293	−317	−355	−317	−870	−2,420
Economic	−148	−131	−95	−81	−75	−75	−76	−79	−82	−88	−530	−929
Technical[3]	−94	−84	−62	−51	−64	−64	−65	−64	−65	−45	−356	−660
Total Changes	−333	−373	−343	−330	−377	−406	−433	−460	−502	−450	−1,757	−4,008
Total Surplus or Deficit (−) as Projected in January 2002	−21	−14	54	103	128	166	202	250	294	439	250	1,602
Memorandum:												
Changes in the Surplus by Type of Discretionary Spending:												
Defense	−33	−29	−29	−29	−29	−29	−30	−30	−31	−32	−149	−301
Nondefense	−11	−20	−23	−25	−26	−28	−28	−29	−29	−30	−106	−249

Note.—For purposes of comparison, this table shows projections for 2002 through 2011 because that was the period covered by CBO's January 2001 baseline. The current projection period extends from 2003 through 2012.

[1] The Economic Growth and Tax Relief Reconciliation Act of 2001, which was estimated at the time of enactment to reduce revenues by $1,186 billion and increase outlays by $88 billion between 2002 and 2011.

[2] Reflects only the change in debt-service costs that results from legislative actions. Other effects on debt-service costs are included under economic and technical changes.

[3] Technical changes are revisions that are not attributable to new legislation or to changes in the components of CBO's economic forecast.

Source: Congressional Budget Office.

Table 2.—THE BUDGET OUTLOOK UNDER CURRENT POLICIES

[In billions of dollars]

	Actual 2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	Total, 2003–2007	Total, 2003–2012
On-Budget Surplus or Deficit (−)	−33	−181	−193	−141	−108	−99	−76	−56	−23	4	131	319	−617	−242
Off-Budget Surplus [1]	161	160	178	195	212	227	242	258	274	290	307	322	1,054	2,505
Total Surplus or Deficit (−)	127	−21	−14	54	103	128	166	202	250	294	439	641	437	2,263
Debt Held by the Public (End of year)	3,320	3,380	3,410	3,373	3,288	3,177	3,027	2,840	2,605	2,325	1,900	1,273	n.a.	n.a.
Memorandum:														
Total Surplus or Deficit (−) as a Percentage of GDP	1.3	−0.2	−0.1	0.5	0.8	1.0	1.2	1.4	1.7	1.9	2.7	3.7	0.7	1.6
Debt Held by the Public (End of year) as a Percentage of GDP	32.7	32.8	31.3	29.2	27.0	24.8	22.5	20.0	17.5	14.8	11.5	7.4	n.a.	n.a.

Note.—n.a. = not applicable.

[1] Off-budget surpluses comprise surpluses in the Social Security trust funds and the net cash flow of the Postal Service.

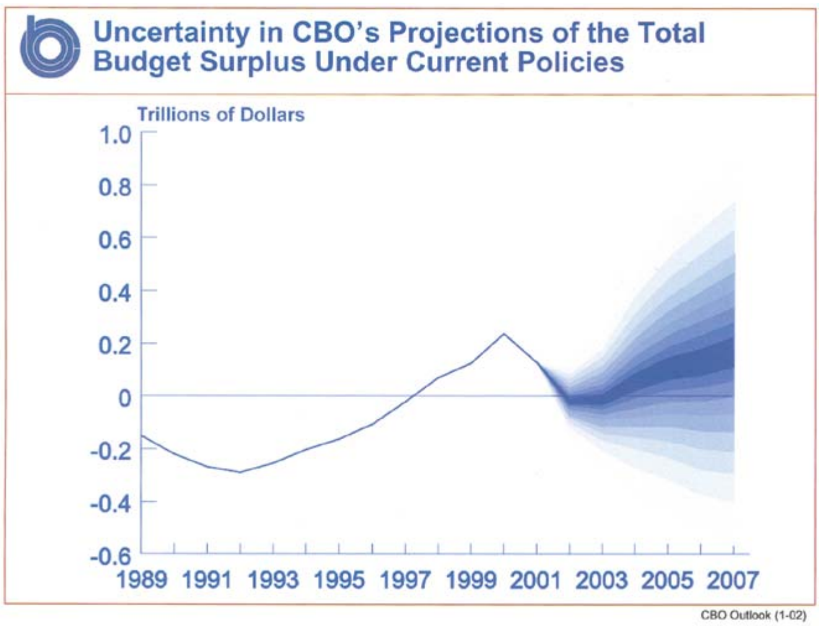
Source: Congressional Budget Office.

Table 3.—CBO'S ECONOMIC FORECAST FOR 2002 AND 2003

	Estimated 2001	Forecast 2002	Forecast 2003
Fourth Quarter to Fourth Quarter (Percentage change):			
Nominal GDP	1.7	4.2	6.5
Real GDP	−0.2	2.5	4.3
Calendar Year Average:			
Real GDP (Percentage change)	1.0	0.8	4.1
Consumer Price Index (Percentage change) [1]	2.9	1.8	2.5
Unemployment Rate (Percent)	4.8	6.1	5.9
Three-Month Treasury Bill Rate (Percent)	3.4	2.2	4.5
Ten-Year Treasury Note Rate (Percent)	5.0	5.0	5.5

[1] The consumer price index for all urban consumers.

Sources: Congressional Budget Office; Department of Commerce, Bureau of Economic Analysis; Department of Labor, Bureau of Labor Statistics; Federal Reserve Board.



Note.—This figure shows the estimated likelihood of alternative projections of the surplus under current policies. The calculations are based on CBO's past track record. CBO's baseline projections fall in the middle of the darkest area. Under the assumption that policies do not change, the probability is 10 percent that actual surpluses will fall in the darkest area and 90 percent that they will fall within the whole shaded area.

Actual surpluses will of course be affected by legislation enacted during the next 10 years, including decisions about discretionary spending. The effects of future legislation are not included in this figure.

An explanation of how this probability distribution was calculated will appear shortly on CBO's Web site (*www.cbo.gov*).

Source: Congressional Budget Office.

CBO'S BASELINE BUDGET PROJECTIONS

	Actual 2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	Total, 2003–2007	Total, 2003–2012
In Billions of Dollars														
Revenues:														
Individual income taxes	994	947	998	1,059	1,114	1,162	1,228	1,305	1,387	1,477	1,673	1,841	5,562	13,245
Corporate income taxes	151	179	175	199	235	246	260	275	289	303	319	335	1,115	2,635
Social insurance taxes	694	710	748	789	832	869	908	948	994	1,045	1,097	1,151	4,146	9,381
Other	152	146	149	159	161	170	172	179	186	183	188	223	811	1,769
Total	1,991	1,983	2,070	2,206	2,342	2,447	2,568	2,706	2,856	3,008	3,277	3,549	11,633	27,030
On-budget	1,484	1,464	1,525	1,632	1,739	1,816	1,907	2,014	2,130	2,243	2,474	2,706	8,620	20,187
Off-budget	508	518	545	574	602	631	661	693	727	764	803	842	3,014	6,842
Outlays:														
Discretionary spending	649	733	764	784	808	824	841	866	888	910	937	953	4,021	8,575
Mandatory spending	1,095	1,188	1,248	1,292	1,362	1,428	1,508	1,602	1,701	1,809	1,933	2,023	6,837	15,904
Offsetting receipts	−87	−88	−101	−113	−119	−115	−122	−129	−136	−143	−152	−160	−570	−1,289
Net interest	206	170	174	188	188	182	175	165	153	138	120	92	908	1,577
Total	1,864	2,003	2,085	2,152	2,238	2,319	2,402	2,504	2,606	2,714	2,838	2,908	11,196	24,767
On-budget	1,517	1,645	1,718	1,774	1,848	1,915	1,983	2,069	2,153	2,240	2,343	2,387	9,237	20,429
Off-budget	347	358	367	379	391	405	419	434	453	474	495	521	1,960	4,337
Surplus or Deficit (-)	127	−21	−14	54	103	128	166	202	250	294	439	641	437	2,263
On-budget	−33	−181	−193	−141	−108	−99	−76	−56	−23	4	131	319	−617	−242
Off-budget	161	160	178	195	212	227	242	258	274	290	307	322	1,054	2,505
Memorandum:														
Gross Domestic Product	10,150	10,315	10,890	11,556	12,168	12,803	13,468	14,166	14,897	15,664	16,469	17,314	60,884	139,394
As a Percentage of GDP														
Revenues:														
Individual income taxes	9.8	9.2	9.2	9.2	9.2	9.1	9.1	9.2	9.3	9.4	10.2	10.6	9.1	9.5
Corporate income taxes	1.5	1.7	1.6	1.7	1.9	1.9	1.9	1.9	1.9	1.9	1.9	1.9	1.8	1.9
Social insurance taxes	6.8	6.9	6.9	6.8	6.8	6.8	6.7	6.7	6.7	6.7	6.7	6.6	6.8	6.7
Other	1.5	1.4	1.4	1.4	1.3	1.3	1.3	1.3	1.2	1.2	1.1	1.3	1.3	1.3
Total	19.6	19.2	19.0	19.1	19.2	19.1	19.1	19.1	19.2	19.2	19.9	20.5	19.1	19.4
On-budget	14.6	14.2	14.0	14.1	14.3	14.2	14.2	14.2	14.3	14.3	15.0	15.6	14.2	14.5
Off-budget	5.0	5.0	5.0	5.0	4.9	4.9	4.9	4.9	4.9	4.9	4.9	4.9	4.9	4.9
Outlays:														
Discretionary spending	6.4	7.1	7.0	6.8	6.6	6.4	6.2	6.1	6.0	5.8	5.7	5.5	6.6	6.2

Mandatory spending	10.8	11.5	11.5	11.2	11.2	11.2	11.2	11.3	11.4	11.5	11.7	11.7	11.2	11.4
Offsetting receipts	−0.9	−0.9	−0.9	−1.0	−1.0	−0.9	−0.9	−0.9	−0.9	−0.9	−0.9	−0.9	−0.9	−0.9
Net interest	2.0	1.7	1.6	1.6	1.5	1.4	1.3	1.2	1.0	0.9	0.7	0.5	1.5	1.1
Total	18.4	19.4	19.1	18.6	18.4	18.1	17.8	17.7	17.5	17.3	17.2	16.8	18.4	17.8
On-budget	14.9	16.0	15.8	15.3	15.2	15.0	14.7	14.6	14.5	14.3	14.2	13.8	15.2	14.7
Off-budget	3.4	3.5	3.4	3.3	3.2	3.2	3.1	3.1	3.0	3.0	3.0	3.0	3.2	3.1
Surplus or Deficit (−)	1.3	−0.2	−0.1	0.5	0.8	1.0	1.2	1.4	1.7	1.9	2.7	3.7	0.7	1.6
On-budget	−0.3	−1.8	−1.8	−1.2	−0.9	−0.8	−0.6	−0.4	−0.2	*	0.8	1.8	−1.0	−0.2
Off-budget	1.6	1.6	1.6	1.7	1.7	1.8	1.8	1.8	1.8	1.9	1.9	1.9	1.7	1.8

Note.—* = between zero and 0.05 percent of GDP.

Source: Congressional Budget Office.

CBO'S BASELINE PROJECTIONS OF DISCRETIONARY SPENDING

(In billions of dollars)

	Actual 2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	Total, 2003–2007	Total, 2003–2012
Budget Authority														
Defense	331	348	357	367	376	386	396	406	417	428	439	451	1,881	4,022
Nondefense	331	363	376	385	394	404	414	425	436	447	459	470	1,973	4,211
Total	662	711	733	751	770	790	810	831	853	875	898	921	3,854	8,233
Outlays														
Defense	306	351	356	363	375	381	387	401	411	422	437	441	1,862	3,974
Nondefense	343	381	408	421	433	443	454	465	476	488	500	512	2,159	4,600
Total	649	733	764	784	808	824	841	866	888	910	937	953	4,021	8,575

Notes.—CBO's baseline projections assume that discretionary spending grows at the rate of inflation after 2002, using the inflators specified in the Balanced Budget and Emergency Deficit Control Act of 1985 (the gross domestic product deflator and the employment cost index).

In CBO's projections, discretionary outlays always exceed budget authority because of spending from the Highway Trust Fund and the Airport and Airways Trust Fund, which is subject to obligation limitations in appropriation acts. The budget authority for such programs is provided in authorizing legislation and is not considered discretionary. Another reason outlays exceed budget authority is that outlays include spending from appropriations provided in previous years.

Source: Congressional Budget Office.

CBO'S CURRENT AND PREVIOUS ECONOMIC PROJECTIONS FOR CALENDAR YEARS 2001 THROUGH 2011

	Estimated 2001	Forecast 2002	Forecast 2003	Projected Annual Average 2004–2007	Projected Annual Average 2008–2011
Nominal GDP (Billions of Dollars)					
January 2002	10,193	10,422	11,063	[1]13,639	[2]16,676
January 2001	10,446	11,029	11,623	[1]14,100	[2]17,132
Nominal GDP (Percentage change)					
January 2002	3.2	2.2	6.1	5.4	5.2
January 2001	4.7	5.6	5.4	4.9	5.0
Real GDP (Percentage change)					
January 2002	1.0	0.8	4.1	3.3	3.1
January 2001	2.4	3.4	3.3	3.0	3.1
GDP Price Index (Percentage change)					
January 2002	2.2	1.4	2.0	2.0	2.0
January 2001	2.3	2.1	2.0	1.9	1.9
Consumer Price Index[3] (Percentage change)					
January 2002	2.9	1.8	2.5	2.5	2.5
January 2001	2.8	2.8	2.7	2.5	2.5
Unemployment Rate (Percent)					
January 2002	4.8	6.1	5.9	5.2	5.2
January 2001	4.4	4.5	4.5	4.8	5.2
Three-Month Treasury Bill Rate (Percent)					
January 2002	3.4	2.2	4.5	4.9	4.9
January 2001	4.8	4.9	5.0	4.9	4.9
Ten-Year Treasury Note Rate (Percent)					
January 2002	5.0	5.0	5.5	5.8	5.8
January 2001	4.9	5.3	5.5	5.7	5.8
Tax Bases (Percentage of GDP)					
Corporate book profits					
January 2002	6.9	6.1	7.0	7.9	8.1
January 2001	8.9	8.5	8.4	8.1	8.0
Wages and salaries					
January 2002	50.0	50.3	50.1	49.3	48.9
January 2001	48.2	48.2	48.2	48.1	48.0

Notes.—CBO's January 2001 projections for GDP and its components were based on data from the national income and product accounts before the accounts were revised in July 2001.

Percentage changes are year over year.

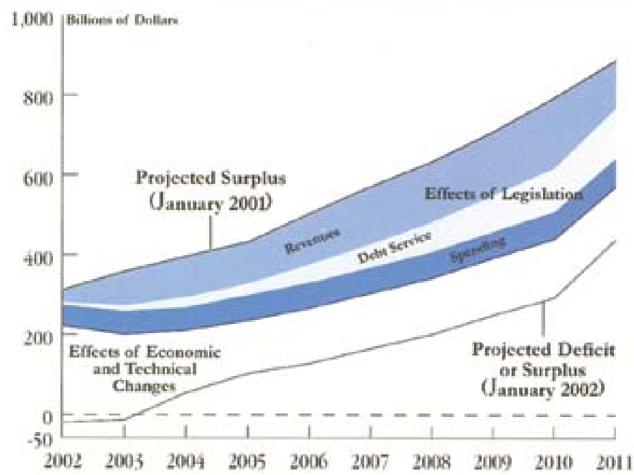
[1] Level of GDP in 2007.

[2] Level of GDP in 2011.

[3] The consumer price index for all urban consumers.

Sources: Congressional Budget Office; Department of Commerce, Bureau of Economic Analysis; Department of Labor, Bureau of Labor Statistics; Federal Reserve Board.

Why CBO's Budget Projections Changed

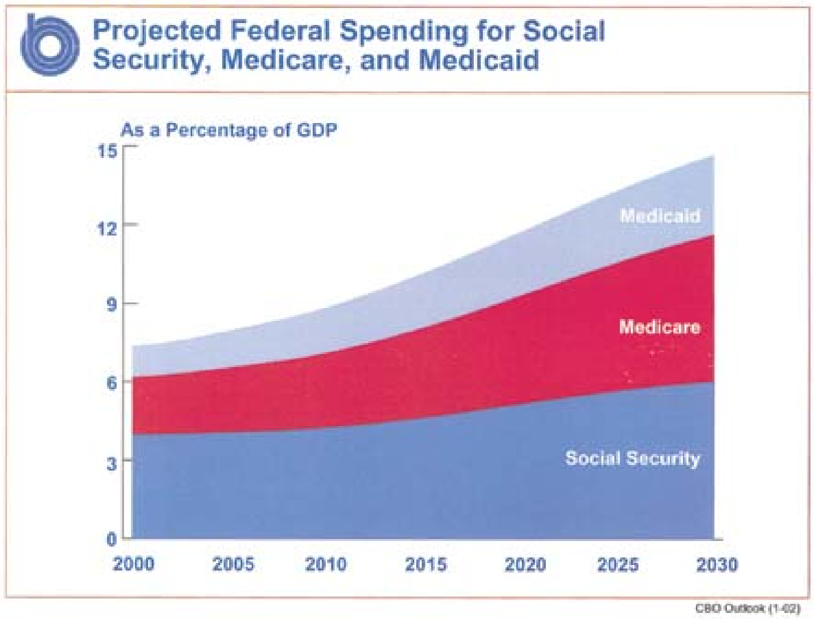


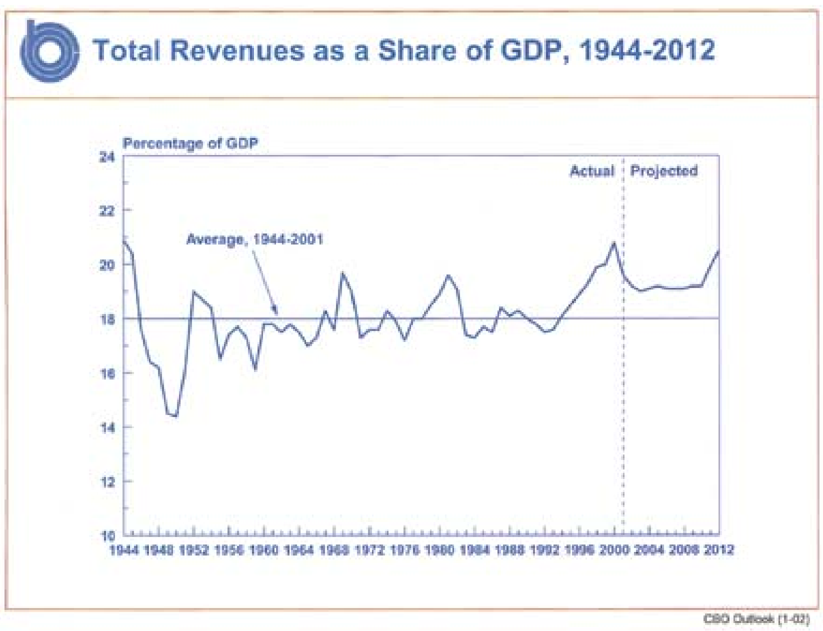
CBO Outlook (1-02)

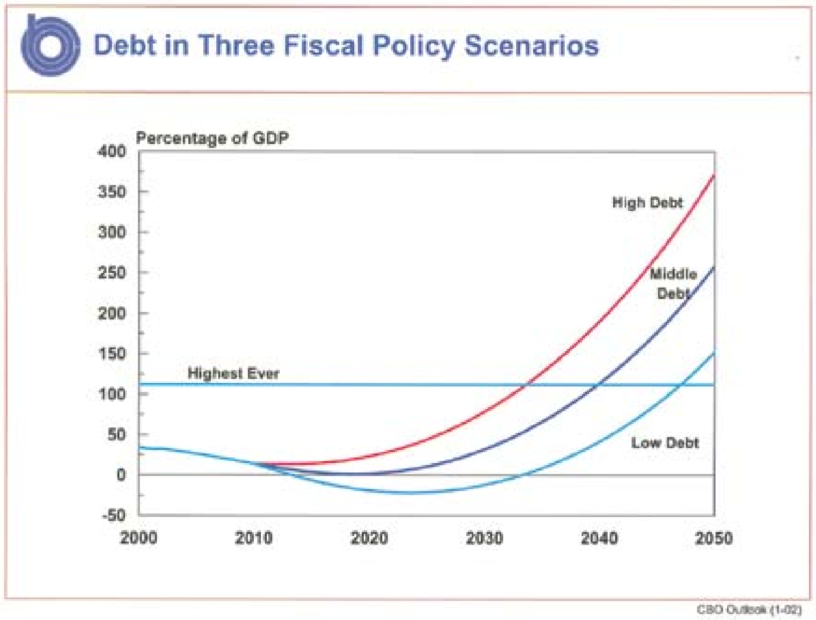
Why CBO's Budget Projections Changed
(In billions of dollars)

	2002	2002-2011
January 2001 Projection	**313**	**5,610**
Legislative Changes		
Tax Law	-38	-1,275
Defense Appropriations	-33	-301
Nondefense Appropriations	-11	-249
Debt Service and Other Costs	-9	-595
Subtotal	-91	-2,420
Economic Changes	-148	-929
Technical Changes	-94	-660
Total Changes	-333	-4,008
January 2002 Projection	**-21**	**1,602**

CBO Outlook (1/02)


Projected Federal Spending for Social Security, Medicare, and Medicaid
As a Percentage of GDP
15
12
9
6
3
0
2000
2005
2010
2015
2020
2025
2030
Medicaid
Medicare
Social Security
CBO Outlook (1-02)


Total Revenues as a Share of GDP, 1944-2012
Percentage of GDP
24
22
20
18
16
14
12
10
Actual
Projected
Average, 1944-2001
1944 1948 1952 1956 1960 1964 1968 1972 1976 1980 1984 1988 1992 1996 2000 2004 2008 2012
CBO Outlook (1-02)



Chairman NUSSLE. Let me start with the basics again, and just to cover your principal reasons for the decline of the projected surpluses, you suggested were, number one, economic factors, and that was to the tune of how much?

Mr. CRIPPEN. Of the 10-year total, it is 40 percent.

Chairman NUSSLE. 40 percent.

Mr. CRIPPEN. For the first year, it is most of it. It is $240 billion out of the $300 billion.

Chairman NUSSLE. All right. The second reason for increased spending and, at least that which you can—because you are not factoring into this some of the items Mr. Spratt was talking about, many of us know are on the horizon, but you don't take those into consideration. Most of that spending was, as I recall—and correct me if I am wrong—but the emergencies, the war and added security.

Mr. CRIPPEN. Yes, mostly. There were some increases before that, but, yes.

Chairman NUSSLE. And finally—go ahead.

Mr. CRIPPEN. That was about 20 percent of the 10-year change.

Chairman NUSSLE. So 40 percent for the economy over 10 years, 20 percent for increased spending over the 10 years, and the tax cut would be——

Mr. CRIPPEN. The rest of it, the 40 or so percent that is left.

Chairman NUSSLE. According to Mr. Spratt's comments to start with, it appears that at least on the House side, the Democrats have taken taxes off the table as one of the possible solutions, and obviously we have. We have made that very clear. In fact, we are very deliberate about taking taxes off the table. That's why the taxes are back on the kitchen table and not out here on the committee table.

So having said that, what are our options for solutions? If the Republicans say we are not going to repeal the tax cut, and in fact we are looking for other ways to stimulate the economy, and the Democrats are suggesting that taxes are off the table, and we are not going to increase taxes, where do we find a solution to getting us back into surpluses in the short term or long term?

Mr. CRIPPEN. Well, in the short term, there aren't many places to go. If you define the problem as the budget not being balanced, then either you raise revenues or cut spending. In a weak economy, of course, most of us would believe that running a deficit is not necessarily a bad thing, that the economy could probably use a bit of stimulation now, and it may be in the pipeline. It may be that we have already turned the corner. Nonetheless, deficits aren't inherently evil when it comes particularly to a weak economy. In the long run, I would argue, what we need to keep our eye on is not so much the balance, particularly of any given trust fund, but rather the size of the economy, and the commitments we are making for our children. For many of these issues, the best way certainly for economists to view it is to look at how much of the economy we are consuming. In that case, there are only two things you can adjust: spending and the size of the economy.

So, in the short run, there is not much you can do, perhaps that you want to do. In the long run, you could grow the economy and grow the revenue base in addition to doing other things.

Chairman NUSSLE. Let me focus then on spending. The baseline that you have presented today assumes that the $20 billion of emergency spending that we approved after September 11 will continue in the baseline indefinitely. Even though none of—well, very little of that, most of it, was not intended to be any more than a one-time expense. Could you explain the reason why CBO puts that $20 billion into the baseline? I mean, if we are looking for places for spending, that may be one of the areas that we can focus on.

Mr. CRIPPEN. It is. There were, of course, two appropriations of $20 billion each last year. One was appropriated for 2001. The second, as you are referring to here, is for 2002. The rules of the road require us to take 2002 appropriations, including this $20 billion, and simply inflate it over the baseline, period. So the $20 billion is added by requirement of the way the rules are written.

I am not sure you would want CBO in the business of saying what is or isn't a one-time expenditure, but as you suggest, only about $3 billion as I recall, $2.8 billion or something like that went to defense in Afghanistan. The rest went to FEMA and other agencies, some of it undoubtedly for ongoing activation to counter for bioterrorism, perhaps, and other things. But some of it, like cleaning up New York City, might be for one-time expenditures, so you are absolutely right. You want to look at what is in the so-called baseline that you would be able to allocate to other things.

Chairman NUSSLE. Finally, and there are a number of members that have questions, so I will limit mine to the 5 minutes. The statutory debt limit comprises both of debt in the private sector and the intergovernmental debt, debt held by the public, debt held by the government, as is typically said. You indicated that the debt is—subject to debt limits, is going to be increasing. Which kind of debt is mainly responsible for the increases over increasing the debt subject to the limit over the past 3 or 4 years, and what does that look like going into the future?

Mr. CRIPPEN. Most of the increase on debt—in fact, all of the increase of the past few years—have been due to intragovernmental debt, that is debt held by other parts of the government; trust funds in particular. Debt held by the public has actually gone down over the past four years. So what has been increasing has been debt held by government accounts to the transfers to trust funds and other Federal accounts. We will have to borrow again from the public, if our projections are right, for the next year or two at least, small amounts hopefully. Then any increase during that time and thereafter almost by definition will be in the government accounts the debt owed to government accounts will be growing, not the debt owed to the public. So it is mostly found in trust funds. The Social Security surplus gets translated into Social Security—or debt held by the Social Security system, which goes into the gross debt number, for example.

Chairman NUSSLE. So boiling it down, one of the biggest challenges we have is to answer the question, are we willing to borrow from the public for a short period of time to deal with the war, the emergency, the recession, some of our priorities, if, in fact, taxes are off the table? And as I said, to make it very clear, taxes are off the table. We have been hearing rumbling that there is a table where some taxes might still be on, but we hear that table evidently doesn't exist over here. It will be very interesting to see where that table exists.

So with that, I will turn it over to my friend, Mr. Spratt.

Mr. SPRATT. Dr. Crippen, on page 2 of your testimony, you say that if current policies stay in place, the budget will be in deficit for the next 2 years, and by that you mean the unified budget?

Mr. CRIPPEN. I do.

Mr. SPRATT. All accounts of the government included?

Mr. CRIPPEN. Yes.

Mr. SPRATT. Now, what I call the basic budget, excluding Social Security, the main and largest trust fund account, will bear a deficit, however, for a number of years, in fact through 2009, will it not?

Mr. CRIPPEN. Yes.

Mr. SPRATT. So, for most of the years in your forecast, there is an on-budget deficit, and if we——

Mr. CRIPPEN. Yes.

Mr. SPRATT. Do you know what the consequences are if we assume, which I think is practical to assume, that the sunset provision in the Tax Act is repealed, what then will be the effect? Won't we have on-budget surpluses for the full 12-year period you have laid out here?

Mr. CRIPPEN. I believe that's correct. The numbers aren't the most current because the Joint Committee on Taxation hasn't reestimated on the basis of our new baseline, but it looks like expiring provisions of revenues would add $162 billion or thereabouts in 2011 and $268 billion in 2012.

Mr. SPRATT. 162 plus 268?

Mr. CRIPPEN. [Witness nodded head.]

Mr. SPRATT. So that would put us in on-budget deficit for the whole time period through 2012?

Mr. CRIPPEN. Yes.

Mr. SPRATT. 168 plus 2——

Mr. CRIPPEN. 68.

Mr. SPRATT. 268.

Mr. CRIPPEN. There are a few other expiring provisions along the way, so it is a small number plus that.

Mr. SPRATT. Do you agree that the on-budget target is an important number?

Mr. CRIPPEN. It is not for me to agree or disagree, Congressman. It is up to you and other members of the committee to say what your target is. What I keep discussing, I am sure, to distraction, is that we need to keep our eye on what I think is a different ball. It is not the budget and its balance or the trust funds per se. It is the effects we have. It is probably a good idea to have a rule of thumb about balance over the average of a long term. But whether or not we are in deficit this year and whether or not we have a surplus next year is much less important than how the economy behaves and how we finance the necessary costs of the Federal Government.

So we said last year, and we will continue to say that if we generated surpluses, if we were looking at 3 percent economic growth, then it might be useful to have surpluses saved by paying down debt held by the public because that should help economic growth and therefore the future outlook. We also said there are other policies that would help economic growth. But right now we are looking at growth that is not 3 percent a year, at least for the next year or two. So not saving—not having surpluses and not saving—shouldn't be something we are as concerned about as we would have been if we had 3 percent growth.

Mr. SPRATT. Well, my concern is that as I read your testimony about dealing with the total surplus, you tend to diminish the extent of the problem as I see it, because Social Security has to be a major concern. The demographics are already in place. It is just a matter of when they unfold.

Mr. CRIPPEN. What I am suggesting, sir, is that the fact that my generation will consume twice as much of the economy as we are consuming today just in Federal benefits will occur whether or not we have trust funds. That will occur whether or not we have balances now or small deficits. That is going to occur. What we need to be mindful of is not just the status of trust funds and just the balance of the Federal budget, but what the effects are on the economy, the obligations——

Mr. SPRATT. We have a different concept going for the trust funds. We want to make them a net addition to national savings for the next dozen years.

Mr. CRIPPEN. Right.

Mr. SPRATT. That would have helped the economy. That also would have helped the Treasury when the baby boomers begin to retire and draw their benefits. The Treasury would have been free of debt to the public and much more solvent and able to meet those obligations as they came due.

Mr. CRIPPEN. All I am suggesting is that that policy looked a little different, in the short run at least, a year ago than it does today. To generate trust fund surpluses, and actually buy down debt held by the public, fiscal policy would be restrictive. Whether or not that is a result you would want in times of weak economic growth or indeed a recession would be a question. So all I am suggesting is that we all keep telling each other today, that a year has made a difference, and the policy that may be most attractive, at least in the short run, may well have changed.

Mr. SPRATT. Well, the difference that is made in the on budget surplus is this year it is $180 billion in deficit, I said surplus. Next year it is $193 billion in deficit; the next year it is 141; 2005, 108; 2006, 99. For the next 5 years, we have got $100 billion to $200 billion in on-budget surplus every year, and that is before any additional spending initiatives or tax cuts, and there are more tax cuts coming for various reasons, extenders and AMT fixes and things like that are bound to come. They are in the agenda. So we have got a problem. Wouldn't you agree?

Mr. CRIPPEN. It depends on how you define the problem. I am not sure. Clearly, the fiscal condition has deteriorated. I mean, $4 trillion is a lot, even over a number of years. But this morning I was reminded as I was listening to some of the questions, that three years ago or four years ago, we wouldn't be quite as distressed if we had been looking at a small deficit in the unified budget and the prospect of surpluses before too long.

Mr. SPRATT. But keep in mind that we are 3 years further along toward the day of judgment, the day of reckoning when the baby boomer retire. Let me put it a different way by going back to your testimony last year.

Mr. CRIPPEN. Do you have to?

Mr. SPRATT. Last year you foresaw the possibility that we could repay, under current policies, all the debt held by the public that was available for redemption by the year 2006 if we simply followed current policies, we could repay all debt held by the public by 2006. This year in your testimony, you say in the whole time frame we are looking at, we won't be able to pay off that much debt.

Mr. CRIPPEN. That's right.

Mr. SPRATT. Last year you said we won't need to have an increase, a hike in the statutory debt ceiling until 2009. Now you acknowledge we will have to do it in about 2 months. Those are real measures of substantial change, but one thing struck me when I compared the two testimonies. Last year, in 2008—looking at a chart that you had, Table 1-4, page 15—in last year's budget and economic outlook. By 2008, CBO projected that we could either pay or provide for payment of all the outstanding debt held by the public. We might not be able to redeem it, but we could certainly provide the payment. By 2008, the year the baby boomers began to retire, the demographics of the country changed dramatically.

This year you project that in 2008, we will still have $2.8 trillion debt. That is before factoring in any of these additional likely further actions. We will only pay down about $500 billion of that debt. We will still be right at $3 trillion as the baby boomers retire.

Mr. CRIPPEN. Right.

Mr. SPRATT. Well, that makes it harder to bear the burden of the demographics and the baby boomers retirement, does it not?

Mr. CRIPPEN. It may or it may not. What I have been trying to convince you of, in part, is that it depends on what we do—or how the economy performs between now and then—more than it depends upon the absolute level of debt. Certainly the lower the debt, the easier it will be for the government to borrow. But as that last chart I introduced showed you, even if we had surpluses 2 percent greater than we have in our baseline, which I think would suggest on-budget surpluses the entire time, you would soon reach an unsustainable level of debt anyway. So it is not just debt that we need to be looking at. It is a larger issue that we are about to run into.

Mr. SPRATT. It is a big problem that has more than one solution. We had one solution in place. There was bipartisan agreement on it, and we virtually dashed all hope that that can be affected under the budget situation we have before us now, I am afraid. Thank you for your testimony.

Chairman NUSSLE. Mr. Sununu.

Mr. SUNUNU. Thank you, Mr. Chairman. Welcome, Mr. Crippen. I think it is important to remember—as I am sure that you do—that what we are talking about today, for the most part, are projections, 10-year projections, economic projections, which are very challenging and very difficult and we see how quickly the economic situation in the country can change. As Mr. Spratt has pointed out in detail—not quite exhaustive detail, but substantive detail—these economic projections have really changed. We see deficits in the foreseeable future. We did have projections of surpluses.

At the same time, though, I can't help but look back a year to a lot of the discussion that we heard as we were conducting hearings, preparing for the budget resolution then, and then what we heard, for the most part, from the minority was a lot of criticism that the projected surpluses were nothing but a fiction. They were an unrealistic projection. They weren't real. They weren't material. While I am as concerned as anyone about the current set of forecasts, I hope that the irony of lamenting the disappearance of something you never believed in is not lost on my colleagues.

I am encouraged as well to hear a pretty firm commitment from the other side that increasing taxes is not an option. I think most people in this country would agree, in the middle of a recession, very uncertain economic times and certainly uncertain times in the international front, it is probably not the best of time to be raising taxes on the American people. What that means is the baseline is the revenue baseline is what it is. We make the best projection we can. We trust on the expertise of you and others. We put together that revenue baseline, and if we want to have a material effect on the surpluses or the deficits projected for the coming fiscal year or the coming 5 fiscal years or the coming decade, there are really only two things that I can see that will affect it. One is enacting policies that result in a higher level of economic growth, and therefore a higher level of revenue collections. Or enacting policies that control, modify or limit or the amount that the Federal Government is spending.

Now, we can lament the change in our economic position all we want. We can wring our hands about legislation that has been signed into law that has established the revenue baseline, but unless you are willing to step forward and say let us repeal that tax cut, let us increase taxes, let us raise taxes on some segment of the economy to increase the revenue baseline, you have got just two options, policies that increase economic growth and increase revenue collection by raising the economic growth rate or policies to control the level of spending, or cut spending. We certainly haven't heard any proposals of that nature from the minority side today or in the last few months.

I would like you to address two points. One in each of those areas. First with regard to economic growth. To the best of the assessment of—you know, best of your ability and the assessment of the people that are working with you, has there been a benefit, an effect, an economic effect to the Tax Relief Act that was signed into law last year? And on the spending side, is there a reason that you have not looked at fiscal year 2002 spending to back out those appropriations that were effectively, or at least presented as one-time distributions, emergency spending, things that were directly—appropriations that were made directly to deal with recovery or reconstruction in New York or Washington, et cetera, that probably shouldn't be part of a baseline that is looking out 10 years? If you could address those two points, I would be grateful.

Mr. CRIPPEN. Let me start with the last point first. The rules of the road, as I call them, by which we have to abide say that we take the total budgetary resources for 2002, which include the $20 billion in supplemental appropriations, and simply inflate them over the next 10 years as the best proxy for an operations policy. As I said to the Chairman a few minutes ago, there may well be things in there, as you suggest, that won't bear repeating and that you might want to use for something else or not spend at all. But I would also say, as I did earlier, that I am not sure you would want us in the business of saying this is one time and this isn't. Some things are clearer than others, but in the main, it is a judgment call that we would be uncomfortable making.

Mr. SUNUNU. Why would you be uncomfortable at least providing your estimate or your assessment of what would be most appropriately considered to be occurring?

Mr. CRIPPEN. I can give you today the breakdown of the $20 billion supplemental, for example, that rules require we put in the baseline, and there are things there that may well strike you as being or that should be one time, but it shows up in agency budgets. FEMA, for example, its baseline is bigger because of the New York City cleanup expenditures. So you may well want to take some of those out or spend them otherwise, but we are not allowed—at least by the rules, and I would suggest we would be uncomfortable trying—to say this is one time and this isn't. But you certainly can, and we can clearly give you a list of where the $20 billion went and for what.

Mr. SUNUNU. And the economic impact of the Tax Relief Act that was signed into law?

Mr. CRIPPEN. Well, we haven't examined it since last July, and we do not—to the frustration of some of you—try to look at the immediate impact of legislation on the economy in our initial scoring of bills. So regarding the tax bill itself, we didn't do an assessment at the time it passed to say whether it would grow the economy or not; but subsequently, we did do a qualitative statement which appeared in our August report, that suggesting there are some negatives to the tax bill in terms of the economy and some positives and that on net it probably has a slight positive effect on economic growth.

Mr. SUNUNU. On Page 5 of your report, you say that the tax cuts enacted in June prevented consumption from slowing more than might have happened otherwise. You certainly stick by that statement?

Mr. CRIPPEN. Absolutely.

Mr. SUNUNU. Thank you.

Chairman NUSSLE. Mr. Bentsen.

Mr. BENTSEN. Thank you, Mr. Chairman. Mr. Crippen, I have a couple of questions for you. First of all, I want to say to my colleague from New Hampshire, I think if anything, we have found out that our theory has moved from the fiction side of the bookstore to the nonfiction side of the bookstore, because I think the numbers bear out that in fact what we were saying, and what even CBO was saying last year was that these projections were highly speculative, and may not turn out. You had a graph last year that was the best graph I think you all put out. You have a revised one now that is the one that looks like a—I think someone described it as a fish fin or something last year. It is—I think it is this graph right here that——

Mr. CRIPPEN. Well, we like to call it a fan, but——

Mr. BENTSEN. A fan, whatever, all over the map, and that is where we have ended up. I mean, it looks to me like we have had an increase in interest costs over the 10-year projection of $600 billion, an increase of—a reduction in the surplus of nearly a trillion dollars. Now, I remember meeting with your staff early last year and asking the question about what the impact would be if we had a severe recession, and if I recall correctly, I was told, well, it wouldn't be more than a hundred or $200 billion, because by the time we had the upswing, that that would be made up, but this is—$900 billion is a little bit more than a hundred or $200 billion. So we clearly missed on that. I realize it is hard to make these projections.

Let me ask you, in your baseline assumptions, does that include any funding for prescription drug program like that that was discussed, even in the Republican budget last year? Does it include the $75 billion additional funding for agriculture that was proposed in the current fiscal year's budget resolution? Does it include the trillion dollars for the President's Social Security privatization? Does it include the—I think I know the answer to this last one. Does it include the 9 percent that we read in real—or 9 percent plus-up in spending that the President is supposed to propose in his budget when he sends it up here at the end of this month or early next month? Are any of those in your baseline?

Mr. CRIPPEN. None of them that you cite.

Mr. BENTSEN. So it is fair to say that the baseline will have to be adjusted, assuming that any of those issues are enacted, including things that even our friends on the other side of the aisle have proposed. If we are going to do a prescription drug program, we are going to have to figure out where to put that in. If we are going to spend $975 billion in the new farm bill, pass it in the House, then we are going to have to figure out where to put that in.

Let me ask you another question, and you can answer this for the record. But I would be interested to know what the economic value is of borrowing money at 4.9 percent over 10 years, or whatever the 10-year Treasury is today, and putting that back in the form of tax cuts. Can your economists tell me do we get a real bang for that or is there some drag associated with that? You can provide that for the record.

Mr. CRIPPEN. OK.

[The information referred to follows:]

RESPONSE TO CONGRESSMAN BENTSEN'S QUESTION CONCERNING DEFICIT-FINANCED TAX CUTS

Tax cuts affect the economy in two ways. They can stimulate the economy in the short run by encouraging consumers and businesses to spend more. Tax cuts can also affect incentives to work, invest, and save, and thus affect the long-term productive potential of the economy. In both cases, the structure of the tax cut is crucial: in particular, which tax is changed, how it affects marginal taxes on work and saving, and how the tax cut is financed.

When there are unused resources in the economy (as there are today or in any recession), a deficit-financed tax cut can boost economic growth in the short run by encouraging spending. However, different kinds of tax cuts can have varying effects: cuts that increase workers' take-home pay probably deliver the greatest bang for the buck in terms of short-run stimulus.[1]

The impact of any short-run stimulus is going to depend in part on the permanence of the tax cut as well as on what people believe it implies for future budget surpluses or deficits. Other things being equal, permanent cuts in personal income taxes are more likely to boost people's consumption than are temporary ones, whereas temporary cuts in some types of business investment taxes can be more stimulative than permanent ones in the short run. The effect of the tax cut on the budget is also relevant because smaller budget surpluses (or larger deficits) in the future can increase long-term interest rates today, which can reduce spending for investment on new plants and equipment and cause the value of the dollar to appreciate, reducing the demand for net exports.

The Congressional Budget Office has examined the short-run effects of the Economic Growth and Tax Relief Reconciliation Act of 2001 using simulations of various macroeconomic models. Although the simulations indicated that the reduction in future surpluses could increase long-term interest rates and slow the growth of investment and net exports, those negative effects were not large enough to offset the short-run positive economic effects of the tax cut. The simulations do not support the view that the tax cut has worsened the recession.

Even though long-term interest rates have remained firm relative to short-term interest rates during the current downturn, the decline in projected surpluses may not have played much of a role. Most observers recognized that the large budget surpluses projected last year were based on the assumption of a continuation of current policies, and thus the projected surpluses would probably not materialize because policies would be changed. Therefore, the substantial reduction in the level of those projected surpluses may not have had a large impact on the markets.

Moreover, several other factors could be responsible for the failure of long-term rates to decline in this recession.[2] For example, the markets may be looking beyond the current slowdown and recognizing that short-term interest rates will rise as the economy recovers. In addition, businesses and financial markets may believe that the prospects for strong productivity growth in the United States are still intact, which would work to keep real long-term rates relatively high. Moreover, foreign long-term interest rates have fallen by only a little. The markets may also be ex-

[1] For more details, see Congressional Budget Office, *Economic Stimulus: Evaluating Proposed Changes in Tax Policy* (January 2002).

[2] See Alan Greenspan, "The Economy" (speech given to the Bay Area Council Conference, San Francisco, Calif., January 11, 2002).

pecting inflation to pick up because of the easy monetary policy put in place by the Federal Reserve in response to the aftermath of the terrorist attacks and to the recession. And last, there may be a recognition that long-term rates are already quite close to their lows of the early 1960's, when productivity growth and inflation rates were near current levels.

Aside from any short-run effects on demand, tax cuts that reduce marginal tax rates can increase incentives for people to work and save, and thus they can have longlasting effects on the economy's productive capacity.[3] The long-run effects of a tax cut ultimately depend on how it is financed. A tax cut cannot be financed by borrowing forever; at some point, spending must be cut or other taxes raised to cover the additional interest costs on the debt. If a tax cut displaces government consumption, it could boost supply in the long run. However, if it is financed by simply raising marginal tax rates in the future, it could have an adverse effect on the economy's productive capacity in the long run.

Mr. BENTSEN. What I am particularly concerned about, and this is on page 6 of your testimony, I think you are as well, I know we have some flexibility in our economic philosophies from when we are in surplus and deficit. We can be Monetarist in surplus times and Keynesian during deficit times. What I am particularly concerned about, and I agree with you, is you say that taking action sooner rather than later to address long-term budgetary pressures can make a significant difference.

What bothers me a great deal about our budget outlook now—and this is what a number of us were saying last year before we went on and bet the farm on these 10-year projections—is while we may go back to achieving a unified budget surplus and even an on-budget surplus some time at the end of the decade but then that we will have already crossed over into the retirement of the baby boomers and then we will be 7 short years away from when we start drawing down on the trust funds for Social Security and Medicare. Then, on top of that, that assumes that we will repeal the tax cut that was passed last year.

Now, if delaying—and I do agree to some extent in the middle of a recession delaying a tax cut is countercyclical. Repealing the tax cut in 2011 certainly would have some countercyclical effect, I would imagine, on the economy going forward. Are we setting ourselves up for sort of the perfect storm, if you will? The fact that we had the opportunity to pay down debt, position ourselves for these long-term, looming liabilities which are upon—if they are not on our doorstep, they are out on the sidewalk at the front yard, and are we—I mean, how much have we set ourselves back rather than setting ourselves forward taking action sooner rather than later?

Mr. CRIPPEN. Perhaps the best way for me to answer that is to say that certainly for this year and next—that is, 2002 and 2003—there is not much that has been done that wasn't inevitable. Eighteen months ago or so, the cover of our summer report tried to show the difference in the outlooks from 1997 in which deficits were still forecast to the surpluses that we didn't foresee then but obviously developed. While there was certainly a legislative piece to it, the actions that you all took back then, much of the difference was due to the economy, the unforeseen growth in productivity and real economic growth. So the short version is, what the economy gives the economy can take away, and that is precisely what we are seeing certainly in the next year or two.

[3] For more details, see Congressional Budget Office, The Budget and Economic Outlook: An Update (August 2001), pp. 34-35.

Mr. BENTSEN. My time is up, but if you would answer this quickly. Didn't last year, when we raised questions about the economy and we had indications that we were heading into a recession or at least a soft landing, we were led to believe—I think by CBO and others—that it would not be a $900 billion event, but today it is a $900 billion event. How did we miss so badly?

Mr. CRIPPEN. That is certainly a fair comment. In our analysis last year at this time, we included a chapter on uncertainty, which explained what a recession might do to the outlook, but it was certainly much less than this recession did. There are several reasons for it. One is that the current recession, while it is not deeper than the recession of 1990 and 1991, it will last longer. We have also had a couple of changes since then in the way the economy produces revenues relative to economic growth, which have reduced revenues.

We thought by modeling the current recession and the analysis on the 1991-1992 recession, we had something that was representative. But that recession doesn't look like the recession today, and a couple of other things have changed. So a combination of both the economy and the changes in what we call technical factors have led us to more of a loss of revenue than we thought a simple recession would have in 1991 or 1992.

Mr. BENTSEN. Thank you, Mr. Chairman.

Chairman NUSSLE. Mr. Gutknecht.

Mr. GUTKNECHT. Thank you, Mr. Chairman.

I appreciate your testimony, and I want to come back to a couple of key points because I think I must tell you I am frustrated by this sort of roller coaster ride we have been on.

I have been on this committee I think 6 or 7 years. Charlie is one of the only members that has been on this committee longer than I have. We have sort of gone through this annual and sometimes a semiannual and sometimes quarterly adjustment; and, you know, it strikes me that we are going to have to come up with better models. These wide fluctuations really make it very difficult for us not only to look at 10-year projections, which I happen to believe are probably not good ideas. Frankly, I think we ought to look at 5-year projections because we see we are off in the 6-month time span, let alone 10 years.

I want to get back to some of the assumptions that you make, because I think in many respects the assumptions are even more important or at least as important as the conclusions.

You are assuming, for example, that economic growth over the entire fiscal year which we are currently in will be eight-tenths of 1 percent, is that correct?

Mr. CRIPPEN. Right.

Mr. GUTKNECHT. What has it been so far this fiscal year? The question from my colleague here was fiscal year or calendar year. Are we going by fiscal year or calendar years here?

Mr. CRIPPEN. We have tables for both, but the number you cited is for the fiscal year. John tells me we don't have any numbers yet on the current year.

Mr. GUTKNECHT. The current calendar year you don't have numbers on. I would assume you have numbers for the fiscal year which began October 1st.

Mr. CRIPPEN. We don't have the fourth quarter. We expect that on the 30th we will have the preliminary numbers for the fourth quarter. So we don't yet have it, but we will a few days.

Mr. GUTKNECHT. That makes it even more difficult, doesn't it?

Let me go back to another question then. We were told late this fall that it was believed by the President's Council of Economic Advisors that the recession began about—on or about March 15. At least that is the date that we were given. When did you find out that we were in a recession?

Mr. CRIPPEN. Well, probably the same time you did in the sense that it is officially designated by the National Bureau of Economic Research (NBER). When they said March, everyone accepted the definition. Certainly by the middle of last year we saw some of the weakening in the economy, but at that point we and others thought that the weakening wouldn't turn into a recession. We were wrong. It did. And we may see some evidence in this fourth quarter report of whether or not it has yet bottomed out. Most of the numbers we are getting now are relatively positive.

Last January at this time, clearly we thought 3 percent growth was possible for the calendar year. By July it was obvious that 3 percent wasn't possible, but it didn't look like zero was going to be it either, and we were just wrong. The economy went south more than we expected.

Mr. GUTKNECHT. Your original assumptions for this fiscal year were what for economic growth?

Mr. CRIPPEN. Around 3 percent.

Mr. GUTKNECHT. So a 2.2 percent drop, just using—making it easy, simple subtraction has cost us in revenue how many dollars?

Mr. CRIPPEN. Well, over the course of the 10 years?

Mr. GUTKNECHT. Over the course of this year. I am not concerned about 10 years. I am concerned about what is going on this year and what will happen in fiscal year 2003.

Mr. CRIPPEN. $150 billion in revenues.

Mr. GUTKNECHT. In revenue loss.

OK. Well, I guess what I want to get to is you go forward. I am concerned, as the Chairman mentioned, that we have automatically built into the baseline—I believe that number is actually larger. You said $20 billion—that was what we believed and I still believe—is emergency spending—is built into the baseline for the next 10 years?

Mr. CRIPPEN. Right.

Mr. GUTKNECHT. Is it 20 or is it 30?

Mr. CRIPPEN. Twenty billion dollars is the amount of the supplemental that was described and put in the defense appropriation bill—I believe in the last days of the Congress—and that was what was described as being emergency, mostly one time. Only about $2.8 billion of the $20 billion went to defense for the war in Afghanistan. Much of the rest of it went to domestic agencies—HHS on bioterrorism, FEMA for New York cleanup. As I said to Mr. Sununu, we had a list of where that $20 billion went.

Now there certainly may be one-time expenditures in the appropriation bills that occurred prior to that. We are required to take the 2002 total, including the supplemental appropriations, and just inflate it.

Mr. GUTKNECHT. That is the other factor I want to get at. What are you assuming for inflation over the next 10 years? I do want to come back to the 10-year projection now. What are you assuming for the inflation rate and how much are you assuming the baseline Federal Government budget will grow over the next 10 years?

Mr. CRIPPEN. There are two inflation factors that get used, one of which is for employment. There is something called the Employment Cost Index, ECI, which I think is about 3.5 percent over the next 10 years. Then, for the rest of the government, there is the GDP price deflator, which is 2 percent or so over the 10 years. So call it 2.5 percent, which is the inflation factor CBO assumes for the next 10 years.

For discretionary spending appropriated accounts, we believe the economy will grow faster than just that inflation rate. But if you add more spending now, of course you will have boosted the base, and it could grow faster than the economy.

Mr. GUTKNECHT. So the base is going to grow somewhere between 2 and a half and 3 percent. You are only assuming that that is roughly the inflation rate.

Mr. CRIPPEN. Right.

Mr. GUTKNECHT. Thank you.

Chairman NUSSLE. Mr. Clement.

Mr. CLEMENT. Thank you, Mr. Chairman.

Dr. Crippen, I think you have been very forthright today, but it is still discouraging to hear what you have had to say.

I heard the Chairman speak earlier about the world has changed, and it definitely has changed in a lot of ways. And I know the Chairman commented also about the tax cut, that, you know, we need something. We have to do—to get a shot in the arm to get this economy moving again.

Now, I see the Bush administration doing a good job on combating terrorism in the world. I give them high marks. But I can't give them high marks on the managing and handling of the economy because I just don't think they have given the same weight to managing the economy as they are combating terrorism, which disturbs me greatly.

Then I see what has happened with jobs and disappearing—I see the people losing their health coverage. I see people suffering a lot of pain now. But I don't see a plan. I know some comments have been made about some legislation yet to be passed by the United States Senate.

But I have to ask you—and knowing that I don't like the so-called 10-year projections either because I don't think we should ever consider anything more than 5 years. Ten years is just out of the question with all the variables and all the forces at work and what is happening in this country and is happening in other countries and how other countries impact America and how America impacts other countries.

What are you expecting next year? I know we have talked about that our projections are wrong for now, you know, and we are way off what we thought the surpluses were going to be and going back into a deficit situation looks like we are going to have deficits for the rest of the Bush administration. But what do you expect for next year?

Mr. CRIPPEN. As far as the economy goes, we anticipate that if we haven't already reached the bottom of the recession we will soon, certainly in the first quarter of calendar year 2002. As one of your colleagues just pointed out, we are assuming about 0.8 percent real growth for the current fiscal year we are in; for the next year, 2003, we assume that real growth will bounce back pretty considerably. But over the next couple of years, we will certainly have unified deficits. We think that, without any further programmatic changes in spending, we will have a small deficit for 2003.

If there are other actions taken by this Congress, which are entirely likely, that number could grow some. But my guess is it is going to be somewhere in the neighborhood of 50 to $100 billion when all is said and done. So the economy will be coming back in our view and in the view of a lot of other forecasters, for whatever that is worth; and the deficit will be probably in the range of $50 billion to $100 billion for 2003.

Mr. CLEMENT. Dr. Crippen, you and I know Democrats and Republicans alike are not going to raise taxes in this recession. It is not going to happen. It is off the table. I would also like to think the Democrats and Republicans alike would consider all the other options.

From my discussions and the meetings I have been in and from a number of people I have talked to, I have to agree with you—or I think you said this a while ago—that this particular recession we are going to come out of it a lot slower than we did in 1991, 1992. But I am not so sure I am hearing that from the Bush administration. That seems to think we are going to turn the corner within the next few months. Which is true?

Mr. CRIPPEN. Well, we will soon see what the administration has to say when they present you with their budget on February 4. They may be slightly more optimistic than we are in the short run.

My guess is we won't be all that much different on economics certainly in the 5 or 10-year framework. But economists are, among other things, not very good at calling turning points in the economy. Whether it was the downturn we didn't foresee a year ago or when we hit the bottom and start back up, it will have happened before we know about it. So it may have happened in December. It may happen in March. My guess is earlier rather than later.

But how quickly we grow, which is the point you have just made, I think is in question because of the nature of this recession. Because it was a dearth of capital spending that started it, it is going to take real opportunities for capital investment to climb again.

Consumers have been carrying their load pretty much all along. The increase in consumer spending dropped from 5 percent over the past couple of years to a 2 and a half percent increase last year, but it still increased. So the primary thing that dropped off was business capital investment and inventories. Until those start rebuilding, we are not going to recover quickly, but we will recover.

Mr. CLEMENT. Thank you, Mr. Chairman.

Chairman NUSSLE. Thank you.

Mr. Thornberry.

Mr. THORNBERRY. Thank you, Mr. Chairman.

Mr. Director, as I think about the roller coaster of projections that Mr. Gutknecht talked about, I am reminded how much your job is more of an art than a science; and it is just intriguing to think what you may be presenting to us next year.

I guess I want to understand something a little better that you have mentioned twice. I think I understand most of the reasons you have here for changes between your last projections, but I come to this line that talks about technical changes, and it talks about that, in a 10-year period, the surpluses reduced by $660 billion, most of that is because of revenue. In your testimony you said that something about revenue collections is lower than the level of economic growth would indicate. So it is telling me something strange is going on.

Something, as I think you said, caused you to change your models; and it seems to me we ought to understand that. If economic growth is the key to solving our population issues, what is happening and what is it that causes the revenue growth to be even lower than the economic situation would indicate?

Mr. CRIPPEN. There are several things specifically in this forecast that I can note for you. One is, and it is clearly related to economics, the amount of capital gains realizations, which in turn, of course, drive capital gains tax collections. People may have a lot of capital gains on paper, but until they actually realize them, they don't incur any tax liability. When people actually realize capital gains is something we haven't been able to model very well.

Mr. THORNBERRY. So they are holding on to things.

Mr. CRIPPEN. They can be holding on to things or not.

Mr. THORNBERRY. Maybe that is a psychological issue of confidence to some degree.

Mr. CRIPPEN. Could be. Part of the surpluses that surprised us came from the fact that people were realizing capital gains faster than we expected they would. Given the level of economic performance, realizations of capital gains were unexpectedly high. Now, realizations are unexpectedly low, given the current state of the economy. That doesn't mean they don't have accrued gains, however, and they may later begin realizing them and paying taxes.

Another thing, as I suggested in the testimony, is that for any given level of the economy, say it is a 3 percent rate of growth, our models tell us roughly what we ought to expect for revenue growth, and they are pretty good on that score. But if you look at month-to-month withholding, for example, on income, at the moment it is running a little behind what our models suggest should be happening, which may mean that our income measures are bad.

There are a lot of revisions that occur in the data we get on income, for example. At the moment clearly the collections are below what we would expect given what we think incomes are. So that ends up being classified as a technical adjustment. We assume, because we don't know better, that those technical adjustments will carry forward.

Then, sometimes we get revised data. We can actually say this unknown that we called a technical last year we now know. We figured it out, and we can put it into the models in a way that shows the adjustment was really economic. So these adjustments are related in some way or another to the economy.

But we are also saying here that there are things going on that we don't fully understand at the moment. Those things are reducing revenues to well below where we would have expected them to be. At the moment, because we don't know better, we can't fathom why exactly this is happening, but we still carry that technical adjustment forward. Am I making any sense?

Mr. THORNBERRY. You are coming as close as you probably can with me——

Mr. CRIPPEN. Or me.

Mr. THORNBERRY.—to making sense.

It does get back, to some extent, that there is a lot we don't know. I guess one could theorize all sorts of things. Maybe people who hold capital assets are expecting a lower capital gains in the future and—their expectations of what we do may play into it.

Let me ask you about one other issue. Mr. Spratt talked a lot about the on-budget surplus. I was kind of interested in an editorial over the break in the Wall Street Journal of one of our colleagues who suggested that what we also ought to focus on—with regard to the debt ceiling is the on-budget debt, if you will—the debt that we borrow from the public, if that is really what ought to be subject to the debt ceiling rather than all of these intergovernmental transfers. Is there any economic pros and cons or light that you can shed on that proposal that it would matter one way or another?

Mr. CRIPPEN. Certainly economists believe that the debt held by the public is the most important because it is the exchange between the government and the private sector. How much the government is going to borrow from our capital markets, from people, is what counts more than how much one part of the government is lending to or borrowing from another. In that regard, a debt ceiling based on debt held by the public would probably make more sense.

The debt ceiling, in my view, was enacted as a way to attempt to control government spending. Having intragovernmental transfers and lending money from one part of the government to another may or may not help you in that regard. But limiting debt held by the public certainly does. Because if you can't borrow, you can't spend what you don't have. Whether or not you can't borrow in between government accounts if you don't have the tax revenue.

Mr. THORNBERRY. Thank you.

Chairman NUSSLE. Mr. Capuano for 30 minutes.

Mr. CAPUANO. Thank you, Mr. Chairman.

Chairman NUSSLE. I will give you five. When you asked for 30, I just wanted to be respectful. Five minutes.

Mr. CAPUANO. First of all, Mr. Crippen, thank you for coming. I think you do a great job with the limitations of all economists. I understand that, and I think you do a fantastic job, and so does your staff.

Before I go, I do want to make sure I understand some of the things in your prepared statement today. I would like to start with the labor statistics. It is my understanding that the labor force is about 135 million people, fair number?

Mr. CRIPPEN. Sounds right.

Mr. CAPUANO. So that a 4.8 percent unemployment rate would actually mean 6,480,000 people out of work.

Mr. CRIPPEN. OK.

Mr. CAPUANO. That means a lot more to me than 4.8 percent, because that is more than the entire population of the State of Massachusetts. It is also more than the entire population of 38 states. I think the number should be on a footnote somewhere.

The 6.1 percent that you are projecting for this year, which I am sure will be in the ballpark of everybody—I know some people differ here and there, but they will be all in the same ballpark—is an increase over the current year's number of 1,755,000 people. That is an increase. That is more than the population of 13 states. It is the entire population of the State of New Mexico or the entire population of the State of Virginia. Everybody—man, woman and child. I think those numbers need to have absolute numbers put to them to make them real. They are faces, they are not percentages. That is more of a footnote than anything else.

On table 2—I am pretty sure I am reading this right, but I want to make sure. As I read this, through 2009 for the next 8 fiscal years, we will be using the money currently paid by all of our people currently paying FICA taxes, Social Security taxes, that everybody who pays them thinks it is going to Social Security, that is the money we will be taking to balance—well, actually to reduce, because we will still have a deficit in two of those years on the remainder of those—to balance the budget. Am I reading that correctly?

Mr. CRIPPEN. You are.

Mr. CAPUANO. So we are doing exactly what virtually every Member of this Congress has said we don't want to do since I have been here, which is now 3 and a half years. So I want to make sure I know that.

I have to go back to some of the original comments. I was under the impression there was a difference between some of the statistics you gave as economic changes versus technical changes. Yet during some of this discussion they were lumped together as all economic. I want to make sure they are not all economic.

Economic and technical, many of the technical changes, correct me if I am wrong, would have occurred or could have occurred regardless of the economic changes. Is that accurate?

Mr. CRIPPEN. Could have, yes. They are related to economic changes, but——

Mr. CAPUANO. But if they were economic changes they would have been put in the economic——

Mr. CRIPPEN. Capital gains realizations, for example.

Mr. CAPUANO. So the economic impact of your changes is really 23 percent, not 40 percent.

Mr. CRIPPEN. Yes.

Mr. CAPUANO. Otherwise, I would have thought——

Mr. CRIPPEN. Pure economic, sure.

Mr. CAPUANO. I tried to extrapolate some of the debt which you didn't have for some of the tables. But all that information is here, it just wasn't in one place.

As I read it, debt service has now increased by $562 billion versus the legislative changes of that 385, give or take, is relative to the tax cut alone. $232 billion for the economic changes, another $165 billion for the technical changes, for a total increase of debt service alone of $959 billion over the next 10 years.

Mr. CRIPPEN. Right.

Mr. CAPUANO. Which is a little short of 25 percent of the total exchange in—I think that is an amazing statement. That by doing tax cuts, by doing additional spending plus the economy, the economy certainly has something to do with it, we have now increased what we are going to pay out in debt service to people. I think that has to be a very clear statement to people, especially since last year we were all thumping ourselves in the chest saying what a great job we were doing reducing the debt, and we did, but we are now significantly increasing it.

I guess really there are now too many questions. That is why I was joking with the Chairman earlier about 30 minutes.

Some of this stuff to me—I also made the mistake of pulling down one of your other reports that was published in January relative to the economic stimulus. I want to read one line, because for me, certainly I am concerned. I am a politician like everybody else. I will be talking about what happened and how we got here. We will all be doing that. But I am more interested in what do we do to get out of it.

One of the major debates is, do we have another stimulus package? Partially one of the debates is with the existing one. But are we going to have another one?

I really recommend to everybody on this committee to, when they read your report, just put out on this thing, are the stimulus packages that are currently on the table, and on page 3 of that report, one sentence, and I will read it, it concludes that most of the tax cuts that the report analyzes, which are most of the major ones on the table now, are unlikely to generate large first-year increases in gross domestic product. Which to me means virtually worthless which if your purpose is to stimulate the economy.

Of the two that you say might have a large impact, if I read them correctly, you say both of them are highly speculative as to whether they will have a change. Is that an accurate reading of this report?

Mr. CRIPPEN. And difficult to implement in some cases.

Mr. CAPUANO. At another time because my time is out, there are so many questions here I look forward to how the OMB director and others are going to suggest we get out of it because there is no one way. I think that is where the debate shall come and not necessarily with you.

I want to finish where I started. I want to thank you for providing this information. It really does help. I want to thank you also for maintaining what is professionalism and neutrality in a place that it is difficult to do. So thank you for that.

Chairman NUSSLE. The gentleman's time has expired.

Mr. CAPUANO. I thought I had 25.

Chairman NUSSLE. Mr. Toomey.

Mr. TOOMEY. Thank you, Mr. Chairman.

Director Crippen, thank you.

A couple of things. I want to touch on this economic growth issue. It seems to me that one of the lessons we clearly should be drawing from this extraordinary change in circumstances that we have witnessed is just how fundamental central our assumptions of economic growth are to that.

I cite on your first page of your testimony you refer to the swing of about $300 billion in this year alone in our projection, and in your testimony it states that over 70 percent of that change results from the weak economy and related technical factors. Seventy percent of this $300 billion swing is a change.

It seems to me pretty clear if we step back and look at just a little bit of history it was surprisingly strong economic growth that surprised us with huge surpluses. It was a surprising downturn in the economic growth, in fact, a contraction, that dramatically diminished the surpluses. And, frankly, if and when we return to strong economic growth we are going to be looking at strong surplus. It seems to me it is all about growth.

I would like to ask you off the top of your head if you have a rule of thumb you could share with us. Over the next 10 or so years, I think you assume about 3.2 percent for the average annual real GDP growth, thereabouts. If that is wrong and it really ends up being 4.2 percent, what is the annual impact? What is the cumulative impact? Do you have a rule of thumb for what 1 percentage growth is worth in budgetary terms?

Mr. CRIPPEN. We do, I think. I am going to rely on my colleagues to answer you in just a second. We have in our report which we publish on the 31st now an Appendix A, which has these rules of thumb as we currently look at them.

A tenth of a point is $250 billion over 10 years.

Mr. TOOMEY. A tenth of a percentage point is $250 billion over 10 years. So if this is linear, which I assume it is, roughly, a point is $2.5 trillion over 10 years.

Mr. CRIPPEN. Probably wouldn't be that much, but it is certainly a big number.

Mr. TOOMEY. Over 2 trillion. It would be a very, very large number.

It seems to me that growth dwarfs virtually everything else. So, therefore, our mission should be to say what do we do to maximize economic growth. I, for one, think that further important tax relief is the way to do that. Others will disagree. But that is what we should be focusing on, it seems to me.

A couple of questions as to how we got where we are. Is it fair to say that we would be in surplus today, in fiscal year 2002, actual numbers, while they are still projected but you would be projecting surplus for 2002, 2003 and beyond had we kept to the spending caps what were passed on a bipartisan basis in 1997?

Mr. CRIPPEN. I don't know that we have done that, but I think you are right.

Mr. TOOMEY. I have a chart that suggests that the discretionary spending cap in terms of budget authority—obviously, outlays ultimately sort of catch up to follow budget authority. We had about $130 billion less spending in 2002 than what we actually spent, about $130 billion. Now the deficit for 2002 is——

Mr. CRIPPEN. Twenty billion dollars.

Mr. TOOMEY. Twenty. So it seems to me—let's put it differently. If we hadn't stuck to the caps but we grew Federal spending each and every year at the rate of inflation, would we in 2002 and 2003—would we be looking at surpluses or deficits?

Mr. CRIPPEN. Surpluses.

Mr. TOOMEY. Large surplus. It seems to me we have been growing spending. My numbers here estimate about 6.1 percent as an average rate of growth from 1997 to 2002. Is that about 2 and a half times the rate of inflation, 2 times the rate of inflation?

Mr. CRIPPEN. Yes.

Mr. TOOMEY. So let me ask another question. This chart is something that you guys produced, right, CBO?

Mr. CRIPPEN. Yes.

Mr. TOOMEY. The way I read this it seems to suggest that the total tax revenue as a share of GDP from 2001 through 2012 is going to be each and every one of those years consistently well above the average total tax as a percentage of GDP in the whole post-war era.

Mr. CRIPPEN. That is correct.

Mr. TOOMEY. If I arrange out the years from 2001 through 2011—thanks for the help—the technical help here. That makes it easier. If you drew an average on that, it looks like the average might even be as high or higher than any point in the post-war era, aside from immediately after in 1944, 1945.

My point is, it seems to me very clear what has happened is spending has accelerated dramatically. It is well above what we said we would spend. Taxes, even with the tax relief package that we passed last year, will remain at historically high levels, post-war era, certainly.

It is amazing to me that anyone thinks that taxes are the problem here. Taxes are very high, still. The problem seems to be spending.

I yield the balance of my time.

Chairman NUSSLE. Mr. Price.

Mr. PRICE. Thank you, Mr. Chairman.

Mr. Crippen, let me add my thanks for your appearance here today and for the quality of your testimony.

I would like to pick up on the line of questioning Mr. Spratt and Mr. Capuano were pursuing regarding the debt held by the public and where we are going with those figures.

You testified a year ago that the publicly held debt would essentially be retired by 2006, that is all of the debt that is available for redemption would be redeemed by 2006. I am not sure what that figure was and how much you calculated would be available for redemption. That whole debate now seems rather quaint as to whether we were going to reach a point of too much debt retirement.

In any case, under current projections, how much has that debt projection for 2006 increased? Just to give us a benchmark, what were you thinking a year ago it will be in 2006? What are you now thinking it will be in 2006? And then how much will the publicly held debt be by 2012, the end of the 10-year period? That is my first question.

The second has to do with the debt service that accompanies the debt. What will the debt service burden be over this period and how much more is that than what you projected last year? I think it is just short of a trillion dollars.

Could you clarify those two figures for us?

Mr. CRIPPEN. On the first figure, my colleagues are scrambling to give you the difference between our projection of debt held by the public last year and this year.

On the second figure regarding debt service, you are right. The debt service costs will be considerably higher that what we projected last year; that, in turn, allows us to retire less debt held by the public over the next 10 years.

Mr. PRICE. The debt service approaches a trillion dollars. That is what you told Mr. Capuano.

While we are getting those actual figures as to what the actual debt is, I wonder if you could comment on the impact of that trillion dollars in debt service. What are the opportunity costs associated with that? We were speaking earlier about the capacity to meet our obligations to Social Security retirees, for example, a decade from now. We all know about things we would like to do with prescription drug coverage for Medicare. These are public and private uses of that trillion dollars that I think most of us would agree are more productive. Do you have any thoughts on that, the opportunity costs of sinking another trillion dollars over the next 10 years into debt service?

Mr. CRIPPEN. Certainly from the point of view of our baseline, without other policies, the primary opportunity cost that is missed here is the ability to pay down even more debt held by the public. A trillion dollars more, just because of debt service, will be held at the end of this 10 years than would otherwise be the case.

As you are saying, there is always an opportunity cost. Rather than pay down debt held by the public as last year's forecast assumed, there is also an opportunity to provide things that folks are interested in doing, such as pharmaceuticals for beneficiaries or cut tax rates. So there is an unlimited range of opportunity costs here.

The economic impact may not be as severe or as important in some ways as the opportunity costs for public programs. The main thing higher debt service cost have done is restrict the ability of us to do more things with the budget, either pay down debt or increase spending.

Mr. PRICE. Some of those programmatic priorities, as important as they are, do remain discretionary. Most of them do. But the necessity of redeeming bonds held by the Social Security trust fund and making good on those obligations when the cash flow in Social Security reverses is not discretionary.

Mr. CRIPPEN. No.

Mr. PRICE. One way or another we are going to have to meet those obligations. Would you not agree that is much more difficult to envision doing if we are carrying a huge debt load and huge debt service load?

Mr. CRIPPEN. That is part of the conversation Mr. Spratt and I were having. It is absolutely true. The more debt presumably we have, the harder it will be to borrow more money.

We have looked at a number of hypothetical fiscal policies you could pursue of having the debt level as we see it today, and we saw it last year, as we could see it get even worse. Under any of those scenarios, we are going to start experiencing a very heavy debt load after my generation retires. So it makes a few years' difference as to when the trajectory really takes off, but only a few years.

What is most important is not the level of debt we hold as we go into the baby-boomer retirement but how much can the economy—can our kids—afford to give us as we retire.

As you said, when the swing takes place, when we start paying out more than we are taking in in payroll taxes, 2011 or so, whether we have a trust fund doesn't matter at that point in some ways. The options for the Federal Government at that point are the same whether or not you have a trust fund, because those bonds have to be turned into cash. So you are going to have to raise taxes, cut other spending, or borrow from the public to get the cash to pay off the beneficiaries. That is the same whether or not we have a trust fund.

So the real impact depends on how many resources we are taking from our kids, not what the level of the trust fund is in this case. But you are right that the lower the debt level the easier it would be for us to borrow, but that is a temporary or, if you will, ephemeral effect. Because eventually, no matter what our debt level, we are going to have to borrow or change other policies by very significant amounts.

Mr. PRICE. I understand that the longer term challenges are daunting. Nonetheless, these years of projected debt reduction are years that we had counted on and that in fact both parties had counted on and had pledged their fealty to not touch the Social Security and Medicare surpluses and apply this to debt reduction so that we would get this debt service off our backs and be more prepared to meet our obligations in the next decade. So I think we are going to have to come to terms rather quickly with the abrupt reversal in those projections.

Do you have the full debt numbers that I requested initially?

Mr. CRIPPEN. Two trillion dollars.

Mr. PRICE. Two trillion at what point?

Mr. CRIPPEN. 2006.

Mr. PRICE. At the end of the 10-year period?

Mr. CRIPPEN. My guess is about three.

Mr. PRICE. If you could clarify those numbers for the record, it would give us a point of comparison. If you will, when you furnish those numbers, put alongside them the projections from this point last year.

Thank you, Mr. Chairman.

Chairman NUSSLE. Mr. Brown.

Mr. BROWN. Thank you, Mr. Chairman.

Dr. Crippen, thank you for coming to bring your words of wisdom to us today and sitting around the table and listening to all the comments about how bad things are. It was so nice when I first came up last year as a freshman to hear how good things were. It is amazing how things could change so rapidly in such a short period of time.

I heard different ideas about how we might be able to make a difference. I noted somebody mentioned 1.8 million folks out of a job that were working last year. You know, the House passed two stimulus packages and sent them to the Senate. I believe I heard you—somebody commented about a report you made that you said that maybe none of those things would work. Did I understand that correctly; that nothing in the stimulus package might change the position in which we find ourselves?

Mr. CRIPPEN. We said that there are a lot of reasons to be skeptical, not that necessarily it wouldn't work, and to be skeptical because it takes a long time to implement any of those stimulus packages. Some of them do not put money into people's hands so they can buy things very quickly. So at this point, what we are saying is it would take a long time to get something that probably would kick in anytime soon.

Mr. BROWN. Weren't we going to give an immediate tax relief for people and tax rebates last year and weren't we going to extend the unemployment benefits from 16 weeks to 39 weeks and weren't we going to accelerate depreciation for businesses so it would give them incentive to purchase additional equipment?

Mr. CRIPPEN. Right.

Mr. BROWN. None of those things might not be of benefit?

Mr. CRIPPEN. They may be of benefit. What we are saying in our response to Chairman Conrad in the Senate was that, of the things that were being discussed at that time—and I think he actually listed them—some were better than others. Things like a payroll tax holiday probably will give you more consumption, if that is your goal, than marginal tax rate cuts in 2006. That kind of makes sense.

Some of the changes in taxation of capital, as you are saying, such as eliminating the alternative minimun tax (AMT) reward past behavior more than they stimulate future behavior. An investment tax cut, on the other hand, would lower the cost of new capital immediately, and that could have a more positive impact than changing taxation of capitol that has already been purchased.

So all we are doing is looking at the timing of these various things. That is not to say they might all be salutary or not salutary at all, but if your objective is to get people and companies to spend as fast as possible, some packages are better than others.

Mr. BROWN. Then I guess, since your background is in investments also, you know, some of us had proposed cutting the capital gains tax thinking that this might help stimulate more investments, too. How do you feel about that proposal?

Mr. CRIPPEN. It certainly might over the long run. My guess is that, in the short run, it wouldn't have much effect on capital expenditures.

Mr. BROWN. But did I hear you earlier say that one of the losses of revenue was in the capital gains section?

Mr. CRIPPEN. Sure. It is in capital gains realized, not just in capital gains taxes. So something has to induce people—you are suggesting—to realize capital gains that increase revenues some. If your goal is in the very short term to get companies to invest, changing the capital gains rules might not have that impact.

Mr. BROWN. I guess my finishing statement is, I don't think we can criticize the President for the economy if we are not going to give him the tools in order to try to make things better. Thank you.

Chairman NUSSLE. Mrs. Clayton.

Mrs. CLAYTON. Dr. Crippen, thank you for being here. I guess I am the one that is holding you up.

Mr. CRIPPEN. There is no place I would rather be.

Mrs. CLAYTON. He is smart and charming. How about that?

I do want to thank you for your testimony. For those of us who are trying to follow your explanation it certainly helps us. So I am appreciative not only of your written word but also of the explanation you are trying to put on it.

I would like for you to explain, the deficit. You are making a new assessment of the deficit. Now it would be something like $21 billion for this year. And on your chart here, you say why. As one of my colleagues tried to make the distinction between the economic and the technical changes, but, whatever the reason, on this page, this column, is we now have a $21 billion projected deficit that we didn't anticipate earlier.

Mr. CRIPPEN. Right.

Mrs. CLAYTON. Did I misunderstand you earlier, that the debt really wouldn't make that much difference in the economy? Was that relative to the extension of that statement as it relates to the trust fund for the Medicaid and Social Security?

Mr. CRIPPEN. It was more related to the trust fund.

Mrs. CLAYTON. Rather than this deficit piece. So having the deficit which means that we have a debt does indeed affect the economy.

Mr. CRIPPEN. In this case, there are a lot of macroeconomists who would say that. Whether you call it Keynesian or not, it might be a good thing to have a deficit so that we can get the economy rolling again. Or, put the other way, it may be a bad thing if we were running big surpluses right now because that would mean the Federal Government was actually helping to restrict the economy or contain it. So in some sense it is not necessarily a bad thing that we have a deficit. Some of my colleagues would say it is appropriate.

Mrs. CLAYTON. So it depends on the situation in terms of society if we need to deficit spend in order to do certain things.

Mr. CRIPPEN. Right.

Mrs. CLAYTON. Along that line, we have needs to fulfill our commitment to Social Security. We have needs to address issues in society like prescription drugs or like Patients Bill of Rights or other areas that we know that would need. And to the extent that we are not able to do that, obviously, society is not helped. But some of this spending is not discretionary. Prescription drug may be discretionary, but Social Security is not.

Whether we are deficit spending or not, our obligation is to our veterans. Our obligation is to those that are in those fixed obligations, whether it is Social Security or Medicare. The deficit we are going to spend and I want my colleague to hear, it is not an option whether we spend or not. There are some things we are going to spend because we are obligated to spend. In my own judgment, there are some things we ought to spend that we are not going to spend for. So it is not a question of whether we spend or give a tax break. The question is how we spend and to what extent we incur debt.

The issue is, if indeed having so much debt will to deter the ability of the economy to raise the quality of life for people, we need to do something in public policy that would stimulate that.

Am I right so far?

Mr. CRIPPEN. Absolutely. I couldn't have said it better.

Mrs. CLAYTON. You get better and better.

I tell you what. You said that the consumers were doing their part and their spending didn't go up 5 percent, but went up 2.5 percent. But the area that you found a void or deficit was business capital investment, right?

Mr. CRIPPEN. Right.

Mrs. CLAYTON. Well, I think the Bush administration wants to give a big corporate tax benefit. Now, I am assuming that projection is based on the fact that, if we did that, we would speak to businesses not investing. Well, the tax that they are proposing is that one of the responses you made to Senator Conrad? Or is that a different tax?

Mr. CRIPPEN. The AMT was certainly one of those.

Mrs. CLAYTON. Let me ask the question then. How do we get businesses to invest their capital so that the economy can be stimulated? Do we do it by the proposal you have heard, the one of the corporate tax break? Does that help? If so, how fast can we do that?

Mr. CRIPPEN. We are skeptical of at least one of the proposals that has been talked about and I think the House passed, which is a major change in the alternative minimum tax for corporations. While its repeal may have positive effects in the future, mostly what the retroactive part would give corporations is a benefit for capital they have already invested. So it doesn't have a stimululative impact. It is more of a retroactive effect.

Mrs. CLAYTON. What was the tax relief for those that invested in foreign countries? They got a tax break. How did that help us?

Mr. CRIPPEN. I think you refer to the FSC.

Mrs. CLAYTON. Does that help the economy?

Mr. CRIPPEN. They can. Although the international trade organizations have now said the provision is not legal in their view, essentially what the provision does is companies who earn revenues abroad a lower tax rate. So to the extent that other economies are allowing our corporations to sell and our people to work and build things to be sold abroad, that means that there is an added bonus to doing that. So it could help. But that is not a big revenue loser or something that is much in play.

Mrs. CLAYTON. I know you say you are not policy, so you are not going to recommend it, but what in your judgment of these options on the table would speak to the lack of businesses investing their capital to stimulate the economy?

Mr. CRIPPEN. First, consumers have to keep up their end. As we have said, they have been doing pretty well. But without consumer spending, without people buying the things corporations and businesses make——

Mrs. CLAYTON. It is hard for them to do that when they don't have jobs. It is hard for them to do that when they are losing their retirements. It is hard to keep that up.

Mr. CRIPPEN. It is all related. But, in addition to consumption, there are things that you could do to change the price of capital for companies. One of the things that was done in the past, for example, was to complement an investment tax credit, which simply gave a credit for the price of a machine simple example. But probably the primary thing you could do is reduce the cost of capital to the point where companies have the rate of return that their shareholders and owners demand.

Mrs. CLAYTON. Greenspan has been doing that, hasn't he?

Mr. CRIPPEN. On the short term interest rate, certainly. The cost of borrowing in the short run has gone down considerably, and the money supply has been growing at a 10 percent rate recently. All of those things should help. Policies that you can pursue would be to reduce the cost of capital in a generic sense which would help companies that are close to being ready to invest, it would push them over the edge and increase investment demand.

Inventory should kind of take care of itself. If consumers are buying and inventories are too low, companies will start building their inventories again. That was the other piece of the downturn that we didn't expect, was heavy inventory sell-off.

I am a little pessimistic that at this point there is anything you can do in the very short run that would dramatically change the outlook. Because this is going to be a slow recovery you may have plenty of opportunities here to think about ways to help over the next several quarters.

Mrs. CLAYTON. Thank you very much.

Chairman NUSSLE. Director Crippen, thank you very much for your testimony today, for presenting the good, the bad, the ugly.

Mr. CRIPPEN. I am the ugly, see.

Chairman NUSSLE. In years past I have been critical about CBO's projections and the way that they can be unpredictable. I don't know if there is any way that anyone could have predicted this last year one way or the other. Certain things were, I suppose, predictable. But what you have reported today had a lot to do with things that were out of everyone's control. We appreciate the way you have given us the news straightforward, the way you always do.

For purposes of announcement, we will be taking testimony from Mitch Daniels, OMB Director, February 5; Treasury Secretary O'Neill on February 6. Unless I am aware of any other time, it will be 10 I believe. OK. 2:30 for the 5th and 10 for the 6th. Hopefully, we will be back in the Budget Committee room at that time.

There is no other business before the committee, we will stand adjourned.

[Whereupon, at 4:25 p.m., the committee was adjourned.]

○