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# UNDERSTANDING AMERICA'S LONG-TERM FISCAL PICTURE

## HEARING

BEFORE THE

## COMMITTEE ON HOMELAND SECURITY AND GOVERNMENTAL AFFAIRS UNITED STATES SENATE

ONE HUNDRED FOURTEENTH CONGRESS

FIRST SESSION

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# CONTENTS



WITNESS

THURSDAY, JULY 9, 2015



APPENDIX

# UNDERSTANDING AMERICA'S LONG-TERM FISCAL PICTURE

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**THURSDAY, JULY 9, 2015**

U.S. SENATE,
COMMITTEE ON HOMELAND SECURITY
AND GOVERNMENTAL AFFAIRS,
*Washington, DC.*

The Committee met, pursuant to notice, at 10:03 a.m., in room SD–342, Dirksen Senate Office Building, Hon. Ron Johnson, Chairman of the Committee, presiding.

Present: Senators Johnson, Lankford, Enzi, Ernst, Sasse, Carper, McCaskill, Tester, Booker, and Peters.

## OPENING STATEMENT OF CHAIRMAN JOHNSON

Chairman JOHNSON. Good morning. This Committee hearing will come to order.

I want to welcome the Director of the Congressional Budget Office (CBO), Dr. Keith Hall, here today and certainly thank you for your time and your appearance and your thoughtful testimony.

The issues we are going to deal with in this hearing are difficult. I was speaking to the Director ahead of time. How do you convey to the American public the depth of the problem so that we collectively can take the first step in solving any problem, which is admitting we have got it? I have done a lot of problem solving in my manufacturing background and you have to first lay out the reality, understand the definition of the problem, describe it properly, but you really have to take that first step and admit we have really got a problem, if you have any hope of solving them.

This Committee has a mission statement, and I do not think we can repeat it enough. It is to enhance the economic and national security of America. And, I think this hearing is going to address both of those components, because I believe, and I agree with the former Chairman of the Joint Chiefs of Staff, Admiral Mike Mullen, when he said the greatest threat to our national security is literally our debt and deficit, and we are going to be talking about our deficit now.

I would define the problem we are facing in terms of our debt and deficit not as a 10-year budget window problem, which is so much of what we are always grappling here with our budgets, it is the 10-year budget window. What we really have is we have a 30-year demographic problem here. We have all the Baby Boom generation people like Senator Carper and myself. We have white hair. Yours is not quite as white as mine——

Senator CARPER. It is getting close. That is OK. At least we still have hair. There you go. [Laughter.]

Chairman JOHNSON. We are retiring at the rate of 10,000 people per day. We have made all these promises to the Baby Boom generation and we really do not have a way to pay for them. We have to step up to the plate and admit that.

Part of the problem is we are not admitting it as political leadership, and I have to repeat this story because it is pretty relevant. I was in the White House. To President Obama's credit, he did go out to dinner with a number of us, and partly, maybe largely because of my prodding, I asked the President, well, if you are serious about making a dent in our debt and deficit, make your White House staff available to us. Let us start working. Let us try and find those areas of agreement, which is what we are trying to do in this Committee. Do not worry about things that divide us. Concentrate on the areas of agreement. I know Senator Enzi is a pro at that in terms of legislation. What can we agree on?

And, so, I brought my accounting skills. I brought that problem definition skill. So, we were in the White House for a 2-hour meeting and President Obama came in for the last half and, of course, he wanted everything on the table. I said, fair enough, Mr. President. If you want everything on the table, here is how you do it, and I slid in front of him a chart[1] that looks something similar to this, 30 years by decade. Here is the size of the deficit. Use your bully pulpit. Take the truth to the American public. Make sure the American people understand the depth of the problem so that, collectively, we can take that first step in solving any problem, which is admitting we have one.

You know what he said to me? He said, "Ron, we cannot show the American public numbers that big. If we do, they will get scared. They will give up hope." And, he says, "Besides, Ron, we cannot do all the work. We have to leave some work for future Presidents, future Congresses." That is not leadership. That is an abdication of leadership.

So, again, the purpose of this hearing is to show the American people the truth. And, what we need to do, as much as I appreciate all the work CBO has done, their long-term projections—and again, let us stipulate, these are projections. It is hard to fully understand and predict out into the future. But, we can take a look at projections and we can compare those to previous history. And, as much as I understand the relevance and the necessity of looking at these things as a percentage of gross domestic product (GDP), the problem is, most people do not deal in percentages. We deal with dollars. That is how we pay for things. So, dollars are more relevant.

And, so, I want to continue to work with Director Hall and the CBO and the economists there of trying to figure out a way to present the reality, the depth of the problem, to the American people so they understand it.

I have a lot of charts and graphs. We developed a one-page income statement, which is on the chart[2] right now, that pretty well lays it out. I mean, by the way, that is the purpose of any income

[1] The chart referenced by Senator Johnson appears in the Appendix on page 48.
[2] The chart referenced by Senator Johnson appears in the Appendix on page 47.

statement. Describe reality, but describe reality for the purpose of directing action. This one-page income statement does that.

In one page, it shows pretty much the financial situation of America on an income basis, and it shows that Social Security will pay out about $14 trillion more in benefits than it takes in the payroll tax over the next 30 years. Medicare pays out about $34 trillion more. And then the rest of the $103 trillion deficit over 30 years which we are going to be talking about today is interest on the debt. Three elements—Social Security deficit, Medicare deficit, and interest on the debt—drive that $103 trillion unsustainable deficit. We need to understand that.

But, let me just throw out one more little factoid here that I think, hopefully, will grab the attention of the audience, of the Members of the Committee, and hopefully the American public. We are all witnessing pretty much the collapse of Greece's welfare system, how unsustainable that model is. And, again, we hear this all the time. I have been here now 4½ years and I have heard witness after witness talk about how our current fiscal situation in America is unsustainable. Let us just do a comparison.

We calculated this number as of the end of the first quarter, so they are comparable between Greece and America. Today, or at the end of March, in America, every American's share of our current Federal debt as of March 31, 2015—every American's share, my share, my kid's share, my grandchild's share—is $56,710. By comparison, the share of every Greek's share of their debt in Greece is $30,786. So, Americans, on an individual basis, our share of our Federal debt is almost double what Greeks' share is of their Federal debt.

Now, why do we not have the riots in the streets? Why do we not have a financial crisis today, like Greece has? Well, because we are the world's reserve currency and we can effectively print money to fund this debt. Greece's creditors have run out of patience. At some point in time, America's creditors are going to run out of patience. They are going to look at America and say, you are not very serious in coming to terms with the debt and deficit. We are not going to loan you any more money. Or, we are certainly not going to loan it at that interest rate. And, at that point, interest rates spike. For every one percent increase in interest rates, that is $180 billion more that is added to our interest payments.

That is what we are dealing with. That is what we have to try and convey. That is what we have to admit.

So, again, I would ask unanimous consent to enter my opening statement into the record.[1]

With that, I will turn it over to Senator Carper for his comments.

## OPENING STATEMENT OF SENATOR CARPER

Senator CARPER. Thanks, Mr. Chairman.

I, too, would welcome Dr. Hall. Thanks. It is very nice to see you again.

And, I would ask that my full statement be made a part of the record.[2]

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[1] The prepared statement of Senator Johnson appears in the Appendix on page 31.
[2] The prepared statement of Senator Carper appears in the Appendix on page 33.

I just want to respond and maybe add a couple of thoughts for us to keep in mind. Harry Truman used to say the only thing that is new in the world is history we never learned or forgot, and I want us just to go back in time a little bit. It is not that long ago we actually had four balanced budgets in a row, and we had a Republican Congress and we had a Democratic President, Bill Clinton. And, when he left office, he turned over a surplus and we had the strongest economy on earth. We were flying high.

Eight years later, the next administration turned over an economy that was going down and some were afraid we were going to go down for the count. The week that this President, the current President, this Vice President, were sworn into office, that one week alone, we lost 600—628,000 people signed up for unemployment insurance. Think about that, 628,000. Two-and-a-half million people lost their jobs in the last 6 months of 2008. Another 2.5 million lost their jobs in the first 6 months of 2009. The budget deficit that year was $1.4 trillion.

And, we have slowly but surely climbed out of here, and it is not just because of this administration, it is not because of the Congress. It is a lot of factors, and I hope—Presidents get blamed for stuff when it goes badly. They also sometimes get credit when things go well. But, we are in a hell of a lot better shape than we were, I think, 6½ years ago.

The deficit for this year is—when the deficit hit $1.4 trillion, it was about 10 percent of GDP. Ten percent, that is a lot. It is still about 3 percent of GDP. We think that is a lot.

I am an old State Treasurer. I was Treasurer of Delaware when we had the worst credit rating in America. We were tied for dead last with Puerto Rico. We were in such bad shape that we would sell tax-exempt revenue anticipation notes—just to meet payroll and make our pension payments. We were the best in the country in overestimating revenues and underestimating spending. That is how we got to have the worst credit rating in the country. So, I bring sort of the thinking of an old State Treasurer and an old Governor to these jobs.

I think there are, like, three things—let us just think of a pie chart of how we spend money in the Federal Government. Over half of it, entitlement spending. Over half of it is entitlement spending. About 5 to 10 percent is debt service. The biggest part of what is left is defense spending, and then the remainder is non-defense discretionary spending. We could wipe out entirely non-defense discretionary spending and we would still have a deficit. So, we have got some work to do here.

The Bowles-Simpson Commission said there are really maybe three things we need to focus on, and one of those is entitlement spending that does not savage old people or poor people, but actually finds a way to save money in these programs, make sure they are going to be around for our kids and our grandchildren, and that is our challenge, and I think we have to be up to that. We cannot walk away from that.

I think we are chipping away at the growth in health care costs, which used to be going up by 18 percent of GDP. We are down now about 17.5 percent. We are trending down in terms of health care costs as a percent of GDP. We have to continue to bring that down—find out what works, do more of that. So, entitlement reform, No. 1.

No. 2, tax reform. Bowles-Simpson says broaden the base. Let us lower the rates. Whatever revenues we generate, we make sure that some of that goes for deficit reduction. I think that makes a lot of sense.

And, the last thing that they said to do was to look at everything that we do, everything we do in government and say, how do we get a better result for less money, every single thing.

I am sure everybody on the Committee remembers something that one of our constituents said to us, maybe at a hearing, maybe at home, that we just have never forgotten. I will never forget a town hall meeting when I was a Congressman. I used to do a lot of town hall meetings then. A woman said to me, "I do not mind paying taxes, I just do not want you to waste my money." That is what she said. "I do not mind paying taxes, I just do not want you to waste my money."

One of the reasons I want to be on this Committee is because we really focus on finding ways not to waste people's money, not to waste taxpayers' money.

So, I am delighted that you are here, Dr. Hall.

Let me say maybe one last thing. The idea of budgeting for—we used to budget for, like, year to year to year to year, and then maybe 5-year budgets and 10-year budgets, now we look out as far as 20 years. If you actually look out 20 years and look how much money we will actually save by implementing most of the Affordable Care Act (ACA), we save hundreds of billions of dollars over the next 20 years, even more than that. If we could somehow figure out how to do something close to comprehensive immigration reform, we would save hundreds of billions of dollars and our GDP would grow, as well.

And, the last thing I would say is this. If we can somehow put our heads together and put our heads around a way to fully fund a 6-year transportation plan, robust 6-year transportation plan—McKinsey Global Institute just gave us these numbers. Here is what they said. One-point-eight million new jobs created and GDP to grow by 1.5 percent a year annually and that is worth doing, and it is also worth paying for, as well.

I will leave it at that. We are glad you are here and look forward to hearing from you.

I am going to be in and out. We are working in Finance on transportation funding right now, so I need to be in and out, so I apologize for that. But, thanks for joining us.

Chairman JOHNSON. Good luck to you in those endeavors.

So, it is the tradition of this Committee to swear in witnesses, so if you would please rise and raise your hand.

Do you swear the testimony you will give before this Committee will be the truth, the whole truth, and nothing but the truth, so help you, God?

Mr. HALL. I do.

Chairman JOHNSON. Thank you. Please be seated.

Our sole witness today is Dr. Keith Hall. He is Director of the Congressional Budget Office. On April 1, he became the Director. He has previously served as Chief Economist at the International

Trade Commission, a Senior Research Fellow at the Mercatus Center at George Mason University, Commissioner of the Bureau of Labor Statistics, Chief Economist for the White House Council of Economic Advisors, and Assistant Professor at the University of Arkansas. Dr. Hall.

**TESTIMONY OF THE HONORABLE KEITH HALL, PH.D.,[1] DIRECTOR, CONGRESSIONAL BUDGET OFFICE**

Mr. HALL. Thank you. Chairman Johnson, Senator Carper, and Members of the Committee, thank you for the opportunity to testify on the Congressional Budget Office's recently released assessment of the long-term outlook for the Federal budget.

CBO has frequently expressed concerns about the likelihood that, under current law, the Federal Government's debt will rise over the next few decades to a level rarely seen in U.S. history and we are pleased to provide some analysis that will help this Committee focus attention on that worrisome prospect.

Let me first talk about that projected increase in debt. CBO's long-term outlook for the Federal budget has changed little since last year. If current laws remain generally unchanged in the future, we expect that Federal debt held by the public will decline slightly relative to GDP over the next few years as the economy continues to move toward greater recovery from the Great Recession.

After that, however, the effects of our aging population and rising health care costs will become more apparent and growing budget deficits will push debt back to and above its current high level. The deficit will grow from less than 3 percent of GDP this year to more than 6 percent of GDP in 2040. At that point, the already high Federal debt held by the public would have risen above 100 percent of GDP.

When making comparisons between amounts of debt in different years, CBO typically expresses debt as a percentage of GDP. Although that measure is not perfect, there are other ways of putting the amount of debt into perspective. This has the advantage of giving some indication of the ability of the United States to reduce or eliminate debt in the future. It accounts for changes in price levels, population, output, and income over time, all of which are important in assessing the sustainability of the budget. Just as a household's income and assets are a measure of how much debt it can reasonably bear, GDP broadly conveys the means available to finance debt held by the public.

I should reiterate that CBO made these projections under the assumption that current law remain the same. In that case, rising incomes would push tax revenues to a level that is high by historical standards relative to GDP. Also, spending for programs other than Social Security and the major health care programs would be quite low by historical standards relative to GDP. If the law did change in a way that kept revenues and spending for those programs close to their historical averages, the result would be even higher Federal debt.

[1] The prepared statement of Mr. Hall appears in the Appendix on page 35.

Though the long-term outlook has worsened dramatically since 2007—in that year, CBO projected that the Federal debt would be below its historical average in each of the next 25 years if current laws at that time had remained unchanged. But then some major changes came along, specifically the Great Recession and some significant alterations to tax and spending laws.

In 2009 to 2012, budget deficits were the largest relative to the size of the economy in any year since 1946, causing the government's debt to soar. The total amount of Federal debt held by the public nearly doubled during that period and is now about $13 trillion. That is equivalent to about 74 percent of the economy's annual output, a higher percentage than at any point in U.S. history except a brief period around World War II.

Under current law, debt is projected to rise continuously relative to the size of the economy in the long run. That path could not be sustained indefinitely. Investors would eventually begin to doubt the ability of the government to cut spending or raise revenues by enough to pay its debt obligations. Such a fiscal crisis would present policymakers with extremely difficult choices and would probably have a substantial negative impact on the country.

Unfortunately, there is no way to predict with any confidence whether or when a fiscal crisis might occur in the United States. In particular, there is no identifiable tipping point in the debt-to-GDP ratio to indicate that a crisis is likely or imminent. All else being equal, however, the larger a government's debt, the greater the risk of a fiscal crisis.

Of course, budgetary outcomes are uncertain. Under current law, unexpected changes in the economy, demographics, or other factors could probably lead to outcomes different from those that we have projected. Nonetheless, our analysis shows that under a wide range of possible outcomes, tax and spending policies under current laws will probably leave the Federal debt in 2040 at a much higher level than it is now, which is already elevated by historical standards.

So, how large would policy changes need to be to lower the trajectory of Federal debt? To put the Federal debt on a sustainable path for the long term, lawmakers would have to make significant changes to tax and spending policies by reducing spending for the large benefit programs below the projected amounts, letting revenues rise more than they would under current law, or adopting some combination of these approaches. The size of such changes would depend upon the amount of Federal debt that lawmakers considered appropriate.

Just holding Federal debt at its current high level of 74 percent of GDP until 2040 would require significant changes in tax and spending policies. A combination of increases in Federal tax revenues and cuts in non-interest Federal spending relative to current law of about 1.1 percent of GDP in each year for 25 years would be needed. In 2016, this would be a spending and/or a tax revenue increase totaling about $210 billion, and more than that for each year after that.

Many combinations of policies could be adopted to meet such a goal. We have illustrated some of those in one of our figures from the written testimony that has been distributed to you. For example, if those changes came from increases of equal percentage in all types of revenues, they would represent an increase of 6 percent relative to current law for each year between 2016 and 2040. In 2016, for example, an average middle-income household would have to pay $750 more in taxes, and more than that each year afterwards.

Or, if the cuts came from cuts of equal percentage in all types of non-interest spending, that spending each year would have to be 5.5 percent less than projected. If the reduction was applied across the board to all types of non-interest spending, an average 65-year-old in the middle of the earnings income who retires in 2016 would see a reduction of about $1,050 in his or her initial annual Social Security benefits, more than that in each year afterwards.

The more ambitious goal of returning public debt by 2040 to its average level over the past half-century, which is 38 percent of GDP, would require more than that. This would require a revenue increase and/or interest spending decrease totaling 2.6 percent of GDP every year. This means an average middle-income household would have to pay $1,700 more in Federal taxes in 2016 and larger amounts in subsequent years. Or, by cutting non-interest spending across the board, average Social Security benefits for a 65-year-old in the middle of the earnings distribution would have to drop by $2,400 in 2016 and by larger amounts in later years.

Regardless of the chosen goal for Federal debt, you as lawmakers would face tradeoffs when deciding how quickly to carry out policies. The sooner significant deficit reduction was implemented, the smaller the government's accumulated debt would be, the smaller the policy changes would be needed to achieve the particular long-term outcome, and the less uncertainty there would be about what policies could be adopted.

Even if policy changes to shrink deficits in the long term were not implemented for several years, making decisions about them sooner rather than later would tend to increase output and employment in the next few years. Such decisions could hold down long-term interest rates, reduce uncertainty, and enhance businesses' and consumers' confidence.

Thank you.

Chairman JOHNSON. Thank you, Director Hall. Again, thank you for appearing and thank you and your staff at CBO for all your hard work.

I think the question is, how do we grab the American people's attention with numbers, with financial data. I am an accountant, you are an economist. I like numbers. You like percentages. It is a difficult problem. It is something I have been grappling with for, literally, 4½ years.

One of my attempts in this was really with a couple amendments that I offered that were adopted unanimously in our budget process this year. The guts of it says the Congressional Budget Office shall provide a projection of Federal revenues, outlays, and deficits for the 30-year period beginning with the budget year expressed in terms of dollars.

This is kind of what I had in mind, and I want to keep working with you. I would really prefer this was a Congressional Budget Office chart so that we did not have to take the detailed information and try and grapple with it and come up with our interpretation, so it was incredibly authoritative, because this is extremely important, that we have a nonpartisan organization, an agency like yourselves, that definitively say, this is what this projection results in, in dollar terms, because, again, people do not pay for their electricity bill and food in percentages. They use dollars. So, Americans understand dollars.

Let us start here, and this is your alternate fiscal scenario, done by decade. I think this lays it out pretty simply, and coming from the business side, I like the KISS principle, keep it simple. First decade, about $10 trillion of projected deficit, according to your alternate fiscal scenario. The second decade, $28 trillion. The third decade, $66 trillion, for a whopping total over the next 30 years, projected deficit by your alternate fiscal scenario of $103 trillion.

Now, again, we are becoming immune to these massive numbers. Who can really understand them? So, I have added to this chart[1] the dollar value of all private assets. The net asset base of America is $116 trillion. That is what we are looking at over the next 30 years.

Now, I want to talk—let us take that one down and put up the next chart,[2] because this is where I will convert to percentages on a relative basis, and it is really going to be the base of my first question. The numbers you were talking about in your testimony, it was really based off your baseline, correct, your baseline projection. I am showing the alternate fiscal scenario.

For me to take a look at projections—this is what I did in business, I would do my budgeting process—I would always take a look at history. Are these numbers relevant? Do they compare to history? So, what I have done—again, trying to keep it as simple as possible—I have laid out percentage of GDP for these spending categories the prior 30 years, from 1985 to 2014. Then I have CBO's baseline projection. And the third column is CBO's alternate fiscal scenario.

So, let us just—again, trying to keep it simple—entitlements, total entitlements, Social Security and health care, the last 30 years, about 7.7 percent of GDP, and under both scenarios, that is expected to rise to 13.1 percent. Now, that is—health care is the more difficult one to really project. Social Security is pretty darn close, right? I mean, we know because of demographics, actuarial math, that type of thing, we have a pretty good handle on Social Security over the next 30 years coming in with about a $14 trillion deficit in terms of what we pay out in benefits versus the payroll tax, is that correct?

Mr. HALL. That is right. Health care definitely has more uncertainty.

Chairman JOHNSON. But, again, so—but, this does show the dramatic increase, 7.7 percent to 13.1.

Now, on defense, the last 30 years, on average, we spent about 4.2 percent, and this includes the 1990s where we really went pretty low historically as a percentage of GDP. According to your baseline, CBO's baseline says over the next 30 years, we will spend about 2.6 percent of GDP. The alternate fiscal scenario is 3.4. So,

[1] The chart referenced by Senator Johnson appears in the Appendix on page 48.
[2] The chart referenced by Senator Johnson appears in the Appendix on page 49.

I guess when I take a look at this, understanding the problems in the world, OK, the threats to our national security, I look at that and I go, that is probably not realistic that we are going to be able to get away with spending only 2.6 or only 3.4 when historically we spent about 4.2 percent. I mean, would you disagree with that?

Mr. HALL. Well, our numbers came from averages, right, so the 2.6 percent is under current law and the bigger number was something close to long-term averages. But, you are exactly right that one of the uncertainties that are there in our forecast is something like a major war, another recession, something like that that would make the picture of the deficit look much worse.

Chairman JOHNSON. Even 4.2, you take a look at the last 50 years, what we had during the Korean War, I think we were at 10 percent. During the 1970s and 1980s, I think we were 8 and 7 percent. We are at historically low percentages of GDP spending already on defense.

Let us go on to all other spending in the Federal Government. Over the last 30 years, it has been about 6.2 percent of GDP. Your baseline says it will drop down to 4.6 percent. Your alternate fiscal scenario is 5.9 percent, OK. And then interest, again, it is the plug figure, and it depends on what we think interest rates will be, and nobody really knows that.

But, I guess the point I am trying to make, if you are really looking at how realistic are these projections, baseline versus alternate fiscal scenario, it kind of gives you a range of projections, I mean, I would look at this, and one of the reasons I use alternate fiscal scenario, I would say of the more likely scenario based on 30 years' prior history, I would just kind of look at alternate fiscal scenario. You could maybe even make an argument that that might still be low as projected deficits. Would you comment on that.

Mr. HALL. Well, we wanted to be careful about predicting what Congress was going to do.

Chairman JOHNSON. I understand.

Mr. HALL. So, the regular baseline is under current law, but our alternate fiscal scenario is trying to look at the way that Congress has behaved in the past. And, so, we did make an effort to do that——

Chairman JOHNSON. Oh, I know, and Congress is very difficult to predict——

Mr. HALL. Yes.

Chairman JOHNSON [continuing]. Other than we will continue to be somewhat dysfunctional.

Let me go, with my remaining seconds here, let me go with the last point. No, first of all, leave on—I want to talk about revenues, because the last 30 years, on average, we have generated about 17.2 percent of GDP in terms of revenue of the Federal Government. Now, if you go back 50 years, it has probably been more around 18.1 percent. So, your baseline shows about 19 percent average over 30 years. The alternate fiscal scenario is really pretty much about that 50-year average.

Now, let us go to the last chart[1] here. This is a chart that shows what percentage of GDP we have raised in revenue comparable to

[1] The chart referenced by Senator Johnson appears in the Appendix on page 50.

the top marginal tax rate. How much are we going to try and punish success and how effective are we at punishing success and dramatically increasing the percentage of revenue we raise as a percentage of GDP? You can see, going back to the late 1950s when we had a top marginal tax rate of 91 percent—now, I think that would give pleasure to a fair amount of people who would like to do that, let us stick it to the rich guys. We still only had about 18.1 percent average. Look how steady that is, regardless of the top marginal tax rate—at 91 percent, at 70 percent, or 50 percent, or 28 percent, or 39.6 percent.

So, I guess I want you to comment on our ability as a Federal Government to try and punish success and do it successfully so that we actually increase revenue to the Federal Government, because to me, it is somewhat of a fool's errand, and when you start dramatically increasing marginal tax rates, I would say you dramatically increase the disincentives for people to take the kind of risk taking that actually helps grow our economy.

Mr. HALL. Well, I do not want to comment too much about specific tax policy things, but you are absolutely right that tax revenue has been fairly much around 18, 19 percent. There has only been a brief time where it was as high as 19 percent, to where we projected under our extended scenario, under current law. So, that is one of the things that I think is a caution, is under our, just our regular extended scenario, tax revenues get to a historically high level and we still have a really significant problem 25 years down the line.

Chairman JOHNSON. Does this chart not basically show that, yes, we can attempt to increase revenue as a percentage of GDP by increasing marginal tax rates, but people change their behavior. I mean, this kind of gets back to the static versus dynamic scoring debate——

Mr. HALL. Right.

Chairman JOHNSON [continuing]. That I think this is a pretty darn good argument that if we are going to change tax policy, we really do need to understand the dynamic effect of those tax policies on people's behavior, and in some way, shape, or form—and trust me, there is a real complexity here in terms of deductions and what type of income, which I think is kind of silly, too, to have different rates on different types of income, income is income from my standpoint—we should dramatically simplify our tax code and I think you might have a little more responsiveness if it were not so complex.

But, anyway, it is just very difficult to really take more than 18 percent away from the American public, is that not kind of—is that not what that chart pretty well shows?

Mr. HALL. Historically, yes. It just has not been done. And let me just say, too, in part of our forecast, we do have a dynamic component in our economic forecast that underlies this and we do have some dynamic effect of the tax rate being to an historically high level. So, that actually does impact economic growth.

Chairman JOHNSON. OK. Well, thank you.

Our next questioner is another accountant, Senator Enzi.

## OPENING STATEMENT OF SENATOR ENZI

Senator ENZI. Thank you, Mr. Chairman. I appreciate you doing this hearing. I know from experience that solving problems early is usually less expensive than solving problems late.

I used to be the Mayor of Gillette and we had some infrastructure problems that we needed to solve and that required us to have some debt. I had to appear before Standard and Poors (S&P) and Moody's and answer how I was going to pay off this debt, and I was kind of stunned by some of the questions because they were all about our retirement system. We were a very young community, so we had everybody at the beginning of their retirement cycle, but what I discovered is that the questioners were on a panel to save New York City, which had a policy of pensions of full retirement at a very young age.

Currently, Greece and other countries across Europe are experiencing economic crises that are due to their pension and entitlement promises that they cannot afford. Given CBO's long-term outlook on the challenges we face, are there any lessons that we can draw from their problem in a short amount of time?

Mr. HALL. Yes. Actually, I do think there is a very important lesson. Greece is going through a very difficult experience, and I think the main thing we ought to take from this is that it is extremely difficult to make fiscal policy decisions under the pressure of a financial crisis. So, this is my "hurry up and make decisions." If you wait until the debt gets very large in the United States and we get something close to a fiscal crisis, then it is very difficult to find fiscal policy decisions that will solve your problem.

Senator ENZI. In your testimony, you mentioned that Social Security would have to be, I think it was a $1,050 reduction in payments, and then more each year. Could you expound on that a little bit more.

Mr. HALL. Sure. What we did was we figured out a fixed percentage of savings we would need to have from spending on Social Security, and the reason that it comes out to that, we were trying to look at something like an average person, what are the costs in 2016, and that number would go up. That is a yearly number, and it would go up based basically on GDP growth. If GDP growth went up, that number would go up and incomes went up. So, that was an effort just to give you some idea of a nice, simple impact on average people.

Senator ENZI. But you meant that it would be just a few additional dollars each year, not a total $1,050 additional reduction?

Mr. HALL. Oh, right. Yes, that is right.

Senator ENZI. I am trying to——

Mr. HALL. That is right.

Senator ENZI. Because, otherwise, pretty quickly, people would be at zero.

Mr. HALL. Oh, right. Right. Yes. No, that is a fixed amount, in percentage terms, anyway.

Senator ENZI. What effect do you think that the collapse of Greece, if they do not meet their Sunday deadline, will have on interest rates for us? Will that make us a more secure country or will people worry about putting their money anywhere as far as buying bonds?

Mr. HALL. Well, so far, the Greek crisis has not had a lot of effect, but probably the biggest effect is going to be through the exchange rate, and it would probably modestly affect our trade balance with the Eurozone. And, if Greece were to—so, I think in that respect, it would be fairly minimal. But, if they were to exit the Eurozone, I think we might get a bit more of effect, where the dollar would appreciate a bit further, Treasury rates would actually fall a little bit, and U.S. equity prices might fall a little bit if they actually pull out of the Euro.

Senator ENZI. Because I keep worrying what will happen with our budget if the interest rate goes to a norm for the United States instead of hovering around the less than 2 percent that we are at now, which costs us $235 billion a year.

Mr. HALL. Right.

Senator ENZI. If that more than doubles, we will be spending more on that than we will be on national defense or all of the rest of the spending that we do that we have control over. There is a whole lot that you point out that we do not have control over.

Now, former Canadian Prime Minister Paul Martin told the Budget Committee a year ago that the No. 1 problem facing Canada during their fiscal crisis in the 1990s was interest payments on the debt. According to Martin, the problem was that the Canadian people would not believe that writing checks to pay interest would hurt as much as writing checks to the government to pay for health care or for living expenses.

Dr. Hall, what is the CBO's long-term outlook for interest payments on the debt in the country, and how does this compare to the amount that we will be spending on health care, for example?

Mr. HALL. Sure. Well, this year, we forecast that our payment, the interest payments on the debt are equal to about 1.3 percent of GDP. And in 25 years, under current law, that is going to go all the way up to about 4.3 percent of GDP. So, that is a pretty significant increase. And, of course, that is going to be sensitive to exactly how much interest rates go up over time.

Also, right now, net Federal health care spending is about 5.2 percent of GDP and it will go up to about 8 percent. So, in 25 years, our interest payments will be about 4.3 percent. Our Federal health care spending will be about 8 percent.

But, let me just point out one thing, though, that between 2015 and 2040, our health care spending is going to go up by about, by our forecast, by about 2.8 percentage points. I know I am using a lot of percentages. I apologize. But, interest is going to go up by 3 percentage points of GDP. So, actually, the increase in the cost of interest will be more than the increase in the cost of health care under our projection.

Senator ENZI. But 12.3 percent of GDP between the two will be a considerable amount.

Mr. HALL. Yes.

Senator ENZI. Now, you have also projected—CBO has projected for many years—and I realize you have only been there a short time, we appreciate all your efforts during that time—but CBO has projected for many years dramatically increasing outlays for federally funded retirement programs. I keep going back to the retirement programs. Indeed, CBO has also argued that revenues will be woefully insufficient to pay for these programs, which means that the government's borrowing requirement will be dramatically increased, as well.

You suggested recently in testimony before the Budget Committee that this public sector borrowing will crowd out private borrowing, which will slow the pace of economic growth. Will this slower pace of growth also reduce worker productivity? Could this reduction in worker productivity result in slower wage and slower growth and fewer job opportunities?

Mr. HALL. Yes, it will, and in our forecast, there is an interesting little rule of thumb. For each dollar that the deficit rises, domestic investment falls by between 15 and 50 cents. So, there is a pretty big impact. And the effect of that deficit on investment, because it crowds out private investment—people's savings get pulled into funding the government rather than funding the making of goods and services—will lead to a smaller capital stock in the economy, less investment, which makes workers less productive and then decreases wages as a result, and we do have some estimates of the amount of income, the average income, how much lower it is because of the borrowing.

Senator ENZI. Can you repeat that very first part? For each dollar——

Mr. HALL. Yes. For each dollar that the deficit rises, domestic investment falls by between 15 cents and 50 cents.

Senator ENZI. Thank you. My time has expired.

Chairman JOHNSON. First of all, Dr. Hall, no need to apologize for using percentages. This is incredibly complex, there is no doubt about it, and that is what we are trying to do, is work with you to try and simplify it as much as possible so we all can understand it.

But, I will make a commitment, by the way. This is just a first in a series of hearings. This is the overall macro look at the budget, trying to come up with some method of simplifying it. We are going to drill down into Social Security, a special hearing on that. We will do it on Medicare. We will probably talk about interest and the effect on the economy from that standpoint, as well.

So, this is just the first in a series of hearings we are going to certainly have under my Chairmanship because this is so incredibly important and because it is complex. It is one of the reasons I do not think we have grabbed the American public's attention, which is what we need to do if they are going to, like I say, admit we have the problem to put pressure on us to fix it. Senator Tester.

## OPENING STATEMENT OF SENATOR TESTER

Senator TESTER. Thank you, Mr. Chairman. Thank you for holding this hearing. Thank you, Dr. Hall, for your testimony.

As I look out into the crowd, there are a ton of young folks here. Are you guys all interns? Raise your hand if you are an intern.

[Show of hands.]

That is good. Well, I appreciate you being here, because, quite frankly, this conversation we are having today impacts you, actually, more than it impacts me, because you will be around a lot longer, I hope, and it is good to have you all here.

Dr. Hall, you talked about the Great Recession and you talked about what transpired, and in that Great Recession that we had, when I got here in January 2007, and I think in about June 2007, I got notification from the Treasury Secretary that we were on the edge of a financial meltdown, or shortly thereafter. But, since that time, when our revenues have dropped and the safety nets like unemployment insurance kicked in, which caused our debt to explode, we have reduced our cumulative deficits by about $4.5 trillion since 2010.

And, before that, as the Ranking Member had pointed out, we did have a balanced budget situation in the 1990s, which was followed by Vice President Cheney, I believe, saying the debt does not matter, which was followed by a tax cut and a war, all put on the credit card at the same time. That is when the economy was booming.

And, so, to have the debt that we have today, with the economic downturn and some of the policies that were put in effect 10 or 12 years ago, should be no surprise to anybody. I am going to leave this Committee and go to an Appropriations Subcommittee in a second—we had a Defense Appropriations Committee where we used an overseas contingency account gimmick to take and put $40 billion additional dollars into that account all on the credit card and nobody is asking anything about it.

Why? Because it is about war, and we can fight wars all over the world and that is OK. We do not need to have France's help, or England's help, or Australia's help, or any of our allies' help. We will do it all on the taxpayers of this country.

So, if we want to deal with the debt and the deficit, we can talk about Social Security and we can talk about Medicare, and we need to, but if we do not talk about what we are doing with foreign policy in this country and how we are going to deal with infrastructure, highway infrastructure that is worn out that will leave the kids in this audience—and if you are under 30, I will call you a kid—with the lack of ability to have a 21st century economy, or many of you are probably going to college and you know you are going to walk out the door with $40,000 or $50,000 in debt and you are not going to be able to buy a house. That is a negative impact on the economy. Or, the fact we do not have an immigration bill and we are not funding research and development, so we are funneling all those jobs to India and Brazil and China and other places around the world.

So, debt and deficit is important, Mr. Chairman, and if we do not take a look at a lot of the policies that get us here, I will tell you what Mr. Bernanke told me when he left office at the Fed. When I said, is the most important thing we are looking at the debt, and he said, no, the most important thing you need to look at is handing the people in this audience, the next generation, a 21st Century economy, because if you do not, you will never pay that debt down. We are not handing these folks a 21st Century economy because we are saddling them with so much debt, personal debt right out of the chute.

We can solve this problem. It is going to take a lot of tough decisions. I think there are people around this dais that are willing to do it, and I think there are people in the Senate that are willing to do it, and I also think there are a lot of folks in the Senate that would rather play politics with this than get to the point, and that is the point I want to make.

The question I have for you, Dr. Hall, is this. You talked about the debt. You talked about projections on the debt. Can we tackle this effort by spending cuts alone?

Mr. HALL. Well, I want to avoid that issue because it is not my job, in a sense. It is your decision to——

Senator TESTER. I know that.

Mr. HALL [continuing]. Obviously, it would be——

Senator TESTER. I just want your estimation. You do not need to get political. You can just say yes or no, and if they beat you up for it, they will beat you up for it regardless, so—these are good people. They will not do that.

Mr. HALL. Well, actually, the scenarios I just gave you were ways to hit targets totally by spending and totally by revenue. So, I did give you sort of the two extremes there.

Senator TESTER. All right. And you are not on this side of the dais, but if you were on this side of the dais, would you be looking at both or would you just be looking at spending cuts or tax increases?

Mr. HALL. Well, again, it is—as a CBO Director, it is not my job to recommend policy. I will talk to you about the possible impact of specific things, and we actually have a document or two giving you some options and what the likely effects would be on how to improve the budget situation.

Senator TESTER. Well, I appreciate that, although I was hoping for a better answer, a more direct answer, but that is the way it is.

I want to just say that I think the debt is very important to handle. I think the American people are very concerned about this. I hear about it every time I go home. Every time I go home, I hear about this. And, I think that if we are able to work together, as I said earlier, in a bipartisan way, we can come to solutions. But, it is going to require some revenue and it is going to require some cuts. So far, we have been cutting to the tune of four in dollars in cuts for every one dollar in increased revenue. I, quite frankly, do not think that is sustainable for a 21st Century economy.

Thank you, Mr. Chairman. Thank you, Dr. Hall.

Chairman JOHNSON. Thank you, Senator Tester.

I do want to respond a little bit. If you want a 21st Century economy, there are some pretty easy elements that we need to concentrate on. For example, let us not artificially drive up the cost of energy. If you want to manufacture things, you need power. Cheap power is better than expensive power. Let us reduce the regulatory burden instead of dramatically increase it, and let us simplify our tax system so we have pro-growth policies. Even with meager economic growth, we have increased revenue to the Federal Government since 2009 by more than $900 billion, with meager economic growth.

Second point, the total cost of the wars since 2001 is probably under $2 trillion——

Senator TESTER. You are not taking into account——

Chairman JOHNSON. I am saying in terms of the effect on the budget deficit today. Less than $2 trillion. We have increased our debt by almost $8 trillion in just 6 years. So, yes, the wars are part of it, certainly not the answer. And in terms of infrastructure spending, totally agree. We should dramatically increase what we are spending on infrastructure for a 21st Century economy. The shortfall in the Highway Trust Fund is about $15 billion per year in an almost 4,000-billion-dollar-a-year budget. Can we not find $15 billion of lower-priority spending and let us spend it on a higher priority? So, that would be my response to that.

Senator TESTER. My response to that would be we just came through the worst recession since the 1930s and that is what caused that $6 billion to go up, income going down, expenses to go up. The other thing is, is we just had a hearing here yesterday with a gentleman from your State that raised chickens, poultry industry. Is that low priority spending? It depends on whose ox is being gored here.

Chairman JOHNSON. And we are going to work to make sure that we take care of that situation, as well. That is why we had the hearing.

Senator TESTER. Oh, I know. But, what I am saying is, is that it was important, and the fact is that somebody living in the middle of downtown Miami might say, the subsidies we give to crop insurance is just not important.

Chairman JOHNSON. No, again, I was not saying that was lower priority. We can find $15 billion of lower priority spending.

I believe it is Senator Ernst.

Senator ERNST. I am not able to stay.

Chairman JOHNSON. Sorry about that. Senator Booker.

Senator BOOKER. I am on the same thing, sir, so unfortunately, I have to go.

Chairman JOHNSON. Senator Carper. I have plenty of questions, so——

Senator CARPER. Dr. Hall, the first question I have for you is how is it going?

Mr. HALL. It is going well. If you mean the budget, it is concerning.

Chairman JOHNSON. It is a mess.

Senator CARPER. People ask me, not all the time, but quite a bit, what keeps me up at night, and I am the senior Democrat on this Committee and we focus a lot on cyber attacks and all kinds of attacks on our country, lone wolves. Those are the kind of things that keep me up at night.

Same question for you. What keeps you up at night, at least on the professional side?

Mr. HALL. Oh, on the professional side, it is sort of my job, is making sure that you have the information you need, Congress has the information it needs to make some tough decisions every day.

Senator CARPER. I have a couple of questions that I want to read, and then a couple of questions I just want to, like, ask off the top of my head. I will take this one that my staff has been good enough to provide for me.

But, if you go back a couple of years—I want to ask about long-term forecasts. It is important for us to, of course, plan for the future and make sure the policies that we put in place, they make sense and they are affordable, not just for now, but for the long run.

But, if someone in 1985 attempted to project our economic and Federal budget outlook like this year, in 2015, I think even the best models could never have accounted for so many factors that have since played a part. We had no idea in 1985, for example, that the Internet would exist, that what happened on 9/11 would come about, the war in Afghanistan, two wars in Iraq, the rise of China and India, the 2008 financial crisis, the Great Recession would happen. A projection made in 1985 would have failed even to account for the savings and loan crisis that began the following year that some of us lived through.

My question would be, how do we strike the right balance here? Knowing that there are so many unknowns, how do we strike the right balance?

Mr. HALL. Well, that is difficult, and, I think one of the things that we strive to do is give you our best estimate. We all know it is probably not going to be right, but we also try to give you some idea of what sort of uncertainty is there.

For example, in the long-term budget outlook report, we go through some scenarios where we change the mortality rate, where we change productivity, it is higher or lower than it has been historically. We change ranges of interest rates and et cetera to give you some idea of what sort of range of outcomes you really could have 25 years from now, besides our point estimate. And, that is to make exactly this point, that things change. It is very hard to predict the outcomes.

But, I think one of the things that we are in a position of saying, though, is under almost any reasonable sort of scenario, the Federal debt 25 years from now is going to be at a very high level and we are headed on a path where it will be unsustainable under just about any of these scenarios under current law, no matter what reasonably happens to productivity or reasonably happens to interest rates, and that is part of our message today.

Senator CARPER. OK. Thanks. I think we would all agree that some level of debt is reasonable and running a deficit is sometimes necessary. I always—the two most common words we hear about, in times of war, in an economic recession to try to prime the pump and get the economy moving. How would you explain to the American people the difference between, say, reasonable debt and unreasonable debt—or unreasonably high levels of debt?

Mr. HALL. Sure. Well, it is a complicated thing. It is one of the reasons that it is so hard to talk about this. And, I would suggest they think about themselves, they think about businesses. is it OK for a household to run debt? Well, yes. How much debt is too much debt? It is not easy to say. It depends upon how big the household is, what the household's prospects are. But, at some point, if a household or a business works up debt, it gets to a level where there is a real concern that it is not sustainable. But, that is sort of a way to think about it.

So, there is no easy, hard and fast rule about how much debt is too much debt because you cannot say that. You cannot look at Starbucks and say, how much debt is too much debt for Starbucks, because you have to look at a lot of things and investors have to make a decision. That is sort of the same thing here for the United States. There is nothing wrong with a running debt, but at some point, you have to think about is the debt too much? Is it getting to where it is going to be very difficult to pay it back over time, and I think that is what we are pointing out, is that we are getting to a level where it is getting very high and it is going to be very difficult to pay it back if we keep our current trends.

Senator CARPER. I am not going to be able to make a perfect analogy here, but I am going to try. Say you have, on the one hand, you have a family, and they are trying to decide what to spend their money on, and if they do not have enough to—for example, one of the spouses or both the spouses want to go back to school, and maybe one spouse will work full time the other spouse go back to school and get a better education, be able to get a better job, or maybe they want their kids to be able to go to school finish school and be more—not just more productive, but actually be able to raise their income, too, or maybe have a choice to want to be able to get to work and you have to go work someplace where you cannot take transit, so maybe you invest in a car.

Those are investments that are designed to enable a family to increase their income. But, when you think about the Federal Government spending money—and the family, they could decide to spend their money to go on a vacation to Hawaii instead of investing in the kinds of things we talked about. In the Federal Government, we can invest in things that actually enhance our long-term economic growth or not, and one of the things I focus on a lot, as my colleagues know, is making sure we are making smart investments in transportation infrastructure, because there is a big payoff there. What are some things that we ought to be investing in? What are some things that we ought to be investing in that maybe we are doing enough of, or maybe not enough of, that will help grow our economy?

Mr. HALL. Well, I am in a position where I cannot give policy advice, but it is certainly true that the type of spending the government had has an impact. One of the things that I think is very interesting about our long-term budget outlook is that if you look under current law and go forward, spending on everything else besides the Social Security and health care goes down to a low level, and it is still unsustainable.

So, my point is that, to a large degree, the big problems here are crowding out perhaps the sort of spending that you are talking about, which can help support economic growth. So, that is sort of part of the message here, I think, that spending on things like that can be worthwhile, but you have to consider, especially if you are going to pay for it with debt, is it going to have an impact on the economy that you want it to have if you are paying it with debt versus something else.

Senator CARPER. All right. Good. Thanks.

Chairman JOHNSON. Senator McCaskill.

**OPENING STATEMENT OF SENATOR MCCASKILL**

Senator MCCASKILL. Thank you.

I do think it is frustrating, because I think there are a lot of misconceptions in America about the budget process and the difference between a deficit and a debt——

Mr. HALL. Right.

Senator MCCASKILL [continuing]. And the difference between austerity and stimulus from an economic perspective. There were a lot of hysterics around the stimulus, but if we look at the data, I think you would agree, Doctor, that the data show the countries that engaged in stimulus did a much better job of navigating out of the hole than those countries that went with an austerity program. Would that be an accurate description of the growth in the various nations, based on the policies they embraced after we fell off the cliff?

Mr. HALL. Well, CBO has weighed in, and there is a consensus in the economics profession that the stimulus did have an effect on economic growth——

Senator MCCASKILL. A positive effect.

Mr. HALL. Yes.

Senator MCCASKILL. But, it is counterintuitive that, when the government is in a bad place because of an economic downturn, that it spends more money, I mean, because all of us in our homes——

Mr. HALL. Right.

Senator MCCASKILL [continuing]. If you are having a bad time, you spend less money. So, it is one of those things that is frustrating, because I think it is complicated——

Mr. HALL. Right.

Senator MCCASKILL [continuing]. For people to step back and realize that stimulative spending is, in fact, a positive for the economy, and, in fact, I think that you would agree, there is a robust debate among the economic community now as to whether or not the stimulus was large enough.

Mr. HALL. Right. Yes, that is true, and let me sort of pivot back to the budget issue, in my mind. The debt has gotten so large, and under current law it is going to get so large, our ability to respond to a future crisis like this is going to be very limited because we have worked up so much debt. And that is one of the concerns, I think, about having such a large debt, is this sort of uncertainty and what could happen with the economy, what could happen with a number of things. So, there is risk involved with having debt this high.

Senator MCCASKILL. So, on the debt, one of the frustrating things as we look at public policy is that we look at the scoring and we try to figure out what it is going to cost. But, you all, for a lot of legitimate and valid reasons, do not ever score the positives of policies—for example, prevention. There is no question that several things contribute to lower health care costs, including spending more money on activities that help prevent illness. But, of course, that is never scored.

Another example would be what we save by having everyone have some skin in the game. By that, I mean the Cadillac policies where nobody has to go in their pocket for anything and they see their health care as free, as opposed to people who have deductibles and copays, what impact that has on, ultimately, the amount of what health care costs are in this country.

I mean, those are two examples. I could give you a lot of other examples. Could you speak to the failure to quantify the money we save with public policy that prevents the spending of money and to calculating only how much money we are spending.

Mr. HALL. Well, when we score things, we do try to take that into account when there is sufficient evidence, where there is some good research and we can——

Senator MCCASKILL. Give me an example of where you have.

Mr. HALL. I can tell you on something we are working on. We have not gotten there yet, but we are looking very hard at the issue of obesity. We have been asked to look at the effects of obesity on health and et cetera going forward. That has turned out to be a very difficult thing to sort of quantify, as to whether that has an effect that is measurable in a budget. But, that is something, actually, where——

Senator MCCASKILL. But, we know it does.

Mr. HALL. Well——

Senator MCCASKILL. It is just quantifying it is hard, right?

Mr. HALL. Quantifying it is hard, and the research is not as straightforward as you might hope. But, we are working on that. We may get there——

Senator MCCASKILL. Not if you take into account the onset of adult diabetes and what we are spending. I mean, all you have to do is turn on the TV. Every third ad is for a blood monitor, all of which we are paying for, right?

Mr. HALL. Right. And, like I say, if we can work out some solid estimates and solid evidence that that is actually true, then that will play into what we do.

Senator MCCASKILL. So, can you give me an example where CBO has taken into account money that we will save by preventing certain activities or changing people's behavior?

Mr. HALL. Can I get back with you on that? I am sure we can dig up something——

Senator MCCASKILL. Because I have always been told, "well, we cannot—that does not count", and certainly on the health care bill——

Mr. HALL. Right.

Senator MCCASKILL [continuing]. They did not count anything for the prevention, and there is obviously a lot of prevention now that is occurring, because people are not having to go in their pocket for prevention. They are able to go and get avasectomy——

Mr. HALL. Well, we are happy to write up something on our views on that.

Senator MCCASKILL [continuing]. Mammograms and so forth——

Mr. HALL. Right.

Senator MCCASKILL [continuing]. Without having to pay for them, and I do not think that that was ever taken into account, even though the health care bill did say it was going to bring down the deficit, and it has, has it not?

Mr. HALL. Well, yes, our forecast is—that is right, that the ACA, on the whole, does do that.

Senator MCCASKILL. OK. Great. Thank you, Mr. Chairman.

Chairman JOHNSON. Thanks, Senator McCaskill.

I do want to address a little bit in terms of stimulus. What you spend money on is pretty important, correct?

Mr. HALL. Yes.

Chairman JOHNSON. I mean, there is no doubt that if you spend a lot of money, that is going to stimulate the economy. But, if you spend it on consumption versus, let us say, infrastructure——

Mr. HALL. Right.

Chairman JOHNSON. Do you know, out of the $800-whatever billion stimulus how much of that was actually spent on something we would consider infrastructure—highways, bridges, that type of thing—versus just getting pumped into, for example, city and State Governments?

Mr. HALL. I do not know that.

Chairman JOHNSON. It is pretty small, though, is it not?

Mr. HALL. I do not——

Chairman JOHNSON. The best estimate I have been able to get out of staff is about $50 billion into what I would consider infrastructure.

Mr. HALL. Right.

Chairman JOHNSON. I want to go back to debt burden and how much you can really carry, because you are right. It totally depends on the circumstance. In a growing organization, you take on a lot more debt because you are going to be a lot bigger in, 5, 10, 15 years. Does it not really come down to debt service, though, in terms of whether you can afford it, and is that not what we are facing right here, is because we are at such historically low interest rates, we are not really feeling the full economic brunt of this enormous increase into our debt, where we are keeping those interest rates artificially low and we are able to service for the time being, but at some point in time, that is going to stop, correct?

Mr. HALL. That is right, and that is in our 25-year forecast. We do have interest rates moving back to more historic levels.

Chairman JOHNSON. To what level?

Mr. HALL. I think we have the Treasury 10-year at something like 2.3 percent. I would have to look that up to make sure.

Chairman JOHNSON. OK. I think right now, as Senator Enzi was saying, I think our total borrowing cost is about under 2 percent. Historically, what we were looking at is about 5.3 percent, overall average interest rate that the Federal Government is paying on its debt.

Mr. HALL. Right.

Chairman JOHNSON. So, I think your estimate is about 4.7 percent, so still under that 50-, 60-year average.

Mr. HALL. Oh, right. Yes. The 4.7 percent is the net interest——

Chairman JOHNSON. Right.

Mr. HALL [continuing]. Is 4.7 percent of GDP——

Chairman JOHNSON. But, basically nominal. That includes inflation, that type of thing.

Mr. HALL. Correct. That is right.

Chairman JOHNSON. OK. One thing you do not include in your forecast is another recession, correct?

Mr. HALL. That is right.

Chairman JOHNSON. I just had staff quickly give me a note on how frequently we have recessions, and dating back to the 1960s, it is about a 9-year, then 3-year, 5-year, 10-year, 10-year, 8-year interval. As an economist, that is about right. Every 10 years or less, we are having another recession, correct?

Mr. HALL. That is right.

Chairman JOHNSON. So, again, your long-term projections, I understand you cannot project out a recession, but we can, based on the past, you can pretty well assume that there will be recessions, maybe three or four or more of those over the next 30 years.

Mr. HALL. Unfortunately, that is probably——

Chairman JOHNSON. And that will make the numbers, the $103 trillion, even worse.

Mr. HALL. Well, that is right. We try to work in the long-run averages through a recession. So, you get some idea of a recession and then recovery, what it averages through that. But, there certainly is risk if there is a recession.

Chairman JOHNSON. And, as Senator Enzi was alluding to, as well, part of the problem we have in terms of getting this under control is so much of the Federal budget is on automatic pilot, that we really only appropriate about a trillion dollars out of what is approaching a $4 trillion budget, is that not correct?

Mr. HALL. Yes.

Chairman JOHNSON. And, so, we do not have a whole lot of room to maneuver on an annual basis in terms of adjusting those things because these are programs that are termed entitlement programs, and if you qualify, it gets automatically spent.

Mr. HALL. Yes.

Chairman JOHNSON. I want to talk a little bit about the difference between total debt and debt held by the public. What is excluded from debt held by the public versus total debt, which right now is over $18 trillion total debt?

Mr. HALL. Right. The idea here is that debt that is held by other parts of government is not included in debt held by the public, and the reason, at least, we focus on debt held by the public is this is the stuff that has economic impact. One part of the government owing money to another part of the government does not really impact the economy like owing to——

Chairman JOHNSON. It is not external debt, but it is a debt of the—for example, the biggest element of that is really Social Security Trust Fund, correct?

Mr. HALL. Yes.

Chairman JOHNSON. And that is about $2.77 trillion worth, correct?

Mr. HALL. I think that is right, yes.

Chairman JOHNSON. Now, to the Trust Fund, that Trust Fund holds about $2.77 trillion of U.S. Government bonds, correct?

Mr. HALL. I think so.

Chairman JOHNSON. So, again, that is an asset to the Trust Fund, right? But, what is a U.S. Government bond—what is it called to the Treasury? A liability, correct?

Mr. HALL. Right.

Chairman JOHNSON. Now, coming from the business world, if you are talking about one overall organization like the Federal Government, you would consolidate the books. So, when you consolidate the books of the Federal Government and you look at a $2.77 trillion asset in the Trust Fund versus a $2.77 trillion liability in Treasury, what does that net out to? Can you say it?

Mr. HALL. Can you run it by me once more——

Chairman JOHNSON. OK. A $2.77 trillion asset in the Trust Fund of U.S. Government bonds is a $2.77 trillion liability to Treasury——

Mr. HALL. It zeroes out, yes.

Chairman JOHNSON. It nets to——

Mr. HALL. Zero.

Chairman JOHNSON. Zero. So, the Trust Fund, the Social Security Trust Fund, in terms of a financial value to the Federal Government, is equal to zero, correct?

Mr. HALL. Right. Yes.

Chairman JOHNSON. It is just an accounting convention. It is a bookkeeping——

Mr. HALL. Right.

Chairman JOHNSON. OK. So, I want to just go through what happens now that we are actually paying out more in benefits that we are taking in the payroll tax. What is currently happening is the interest on those bonds are still being paid into the Trust Fund and the interest is covering the deficits currently. But, in a few years, the interest payments will no longer cover the expanding deficit in Social Security. So, the Social Security Trust Fund is going to have to start cashing those bonds in to the Treasury, correct?

Mr. HALL. Yes.

Chairman JOHNSON. So, they will take a bond, maybe $100 billion if that is the shortfall, give it to the Treasury, the Treasury will give them $100 billion to pay out benefits. But, how does the Treasury get that $100 billion?

Mr. HALL. They borrow it from somebody else.

Chairman JOHNSON. They borrow it. So, I guess, from my standpoint, the debt held within these agencies is an obligation. I realize we do not recognize it as such because, I think by Federal law, we really do not have to—we are really not obligated to make Social Security payments. Social Security is really not a pre-funded retirement fund.

Mr. HALL. Right.

Chairman JOHNSON. We did not really take those funds in and put those into an account for an individual taxpayer, correct? We brought that money in. We spent it. And in its place, we issued a U.S. Government bond. In a previous hearing, we actually had the Trust Fund. We have a picture of it. We did not bring it today. It is a four-drawer file in Parkersburg, West Virginia. That is what politicians from both parties are telling the American people, looking them straight in the eye and lying to them, saying that that is going to fund Social Security deficits for the next 20 or so years. It does not do that, does it?

Mr. HALL. No.

Chairman JOHNSON. No. So, the Trust Fund is a fiction. By and large, the Trust Fund is a fiction. It has no financial value to the Federal Government.

Now, had we—just real quick—had the Federal Government actually taken those surpluses and invested those in assets outside the Federal Government, for example, maybe a Dow Jones stock index fund, those would be a real hard asset that then the Trust Fund could actually cash those in and a different entity could have paid that and that actually would be funding benefits. But, that is not what happened, right?

Mr. HALL. Right.

Chairman JOHNSON. We took the money and we spent it. It is gone. And all we have in place of it is a piece of paper that basically says, $2.77 trillion. OK. We will be exploring this in far greater detail in a future hearing. Senator Carper.

Senator CARPER. Thank you.

I want to go back to the analogy of the family trying to figure out how to spend their money. Say you have a family that is renting. They were trying to decide whether to buy or just to continue to pay rent payments, and mortgage payments are maybe attractive—or mortgage rates are attractive, so they are tempted to actually buy a house, and they finally decide maybe that is in their best long-term interest.

We rent a lot of space, as you know, in the Federal Government—a lot of space—and we sometimes wonder, well, maybe should we just go ahead and buy something or build something? Would we be better off? Would the taxpayers ultimately be better off? And, I think there is a lot of reason to say, yes, we would, and it is just not my conjecture, but folks a whole lot smarter than me.

I think it was the Government Accountability Office (GAO) who—or maybe it was the General Services Administration (GSA)—but on the issue of Homeland Security, Department of Homeland Security continuing to rent space all over kingdom come. They rent a lot of space, and, it is a big agency, huge, dozens of agencies that are part of it. They are far-flung across this area and, really, across the world. But, they are trying to consolidate in one area, not all the Department, but big pieces of the Department. Former Secretaries Tom Ridge, Judge Chertoff, Janet Napolitano, all said in terms of actually managing the Department, it makes a whole lot of sense.

But, we are also told by GSA that if they do that consolidation and we build, that over the next 30 years, we will save taxpayers over a billion dollars. But, yet, we continue to rent space, lease space as opposed to buying or building.

What can we do in order to better ensure we make smarter decisions when it comes to acquiring space, paying for space? What do we need to do on our legislative side? My sense is that your hands are tied because when we try to buy or build, it does not score well because we have to account for everything up front as opposed to paying for renting something for 30, 40 years. What can we do to help make sure we just use some common sense here?

Mr. HALL. Well, I suppose it is making the decision about it, obviously. It is understanding what the cost and what the extra cost, or not extra cost will be of buying versus renting, that sort of thing.

Obviously, in terms of scoring something like that, that is something that we do routinely. We do not constrain anybody in that.

We just are trying to be clear what is going to be the impact of spending on something like that.

Senator CARPER. Well, the way that the scoring occurs now, when the agency can clearly demonstrate—GSA said an agency can clearly demonstrate that a lot of money is going to be saved for taxpayers if we buy or build as opposed to continue renting, but yet we continue to rent or lease. Is there something that we need to do at the legislative branch in order to make sure we use some common sense, or enable you and your folks to use some common sense here?

Mr. HALL. I do not think I have any advice on that, to be honest. It is something, I suppose, if you are interested in us following up on something like that, on likely the scoring impact of that sort of thing, we can talk about that in a Q and A afterwards, if you would like.

Senator CARPER. Good. All right. Well, this is one I have been interested in for a while, so I will look forward to that conversation.

Senator McCaskill was over here talking about prevention and that sort of thing. Major health care cost drivers, there are a lot of them, but among those major drivers are obesity. Among the drivers are dementia. I think we have about five million people that are suffering from Alzheimer's disease, dementia today. That number is expected to grow. I used to think the drivers in Medicaid were, like, women and children. As it turns out, I am told maybe three-quarters of what we spend in Medicaid these days are for folks, older people in nursing homes, a lot of whom have dementia.

Another health care cost driver is end-of-life care. We spend a huge amount, as you know, in the last 6 months of our lives. In some cases, people maybe do one of these advanced care directives or, stipulating what kind of care they would like to have in the last months or years of their life and they find that if they are in, like, a hospital, then they are fine, but if they get transferred to a different facility, there is no portability of that directive.

I work out. I love to work out every day of my life, almost, and one of the places I work out is the YMCA back in Delaware, and there is a woman who works out there from time to time and I was talking to her. She is in great shape. I think she is in her 50s. She is in terrific shape. I asked her if her parents were also, like, really in good physical shape, and she said that they are deceased. I said, really? What happened? And she said her mom died of colorectal cancer, and I said, how old, and she said, like, in her 50s. And, I said, why? She said, she just did not want to get those screenings. They just did not like to do them. They were just uncomfortable, unpleasant, and she would rather than do that just take her chances. She died, a miserable death, too, I might add.

One of the things we did in the Affordable Care Act is we basically tried to make sure people get their screenings, whether it is colorectal, whether it is prostate, whether it is breast, but I do not know that we always score those, and in the end, we know we save a lot of money. But, the score is not encouraging for us to do what in the end saves money.

Could you just comment on what we need to do to change that?

Mr. HALL. Well, actually, if you like, I think I mentioned this to Senator McCaskill, that if you like, we can followup with some description of how we score things like that and what sort of process we go through in looking at how to score something like that.

Senator CARPER. OK. The last one I would ask, just briefly, GAO has finally put on their High-Risk List the issue of climate change. They pointed out that enhancing resilience in communities may carry some up-front costs but could reduce the damages in the future by a lot. How should CBO factor into its analysis the growing costs of climate change to the economy and the Federal budget?

Mr. HALL. We actually have done a little work on that.

Senator CARPER. Have you?

Mr. HALL. Yes, we have. We have looked at estimates of increased hurricanes and drawn that sort of a trend and it does have an impact on GDP. It is not a big impact on GDP. In fact, I think we have a little discussion, actually, in this report on that. And, the reason it does not have a big budgetary impact, of course, is because the shared economy that is spread along the coast is not that big and the ag effects can be kind of mixed, because you can actually have an agricultural boost somewhere else where you have it on a negative.

But, we do have that—we do have some discussion on that, and we are, in fact, doing some more detailed work on the impact of increased hurricanes and maybe rising sea level. So, we will actually have some work on that pretty soon.

Senator CARPER. Good. Well, we look forward to that. Thank you. Thanks very much, Mr. Chairman.

Chairman JOHNSON. Thank you, Senator Carper.

By the way, to both you and Senator McCaskill, if you are looking for an ally, there is a concept out there, the cure strategy, which I think is exactly the direction we should be going on.

As a fiscal conservative, I think it is money really well spent to try and cure diseases, and what I would love to do is get a commitment of CBO to really take a look at some of the projections, for example, on how much we are going to be spending on Alzheimer's if we do not come up with a cure. What is the current cost of just diabetes, those types of things.

I think it is kind of hard to—in my guess, it would be very difficult to project prevention, and say, if you do this—but we can certainly have a pretty good hard number on what we are spending treating diabetes, what we are spending treating Alzheimer's, and then do the demographic projection in terms of how many, with the aging population, what that is going to cost. I know the Alzheimer's Association has done those types of things. So, I think those are extremely good numbers and the types of information you would need to help direct action, which kind of gets us back to the point we were making in this Committee.

It is really about how do we simplify how we project, how we communicate those projections. It is about providing information, not relying on demagoguery anymore, because the only way we are going to solve these problems is, again, lay out the information, lay out the facts, have a very unbiased, nonpartisan intermediary, arbitrator of the information so that we are not sitting and battling over, well, this is my figure, that is your figure, but we can kind of come together and go, OK, let us at least first agree on the figures as best we can, understand what underlies them.

So, again, I am hoping that, we have reported a lot of pieces of legislation. We have come to CBO in the past looking for scores. I know you are busy. I am hoping you are valuing this, and I hope you understand the direction I am trying to go here. Let us simplify things. Let us get information to the American public. Let us get information to policymakers so that we are on the same page.

So, I certainly am looking for a commitment out of CBO to, with what limited resources you have, and on a prioritized basis—and we are not going to overburden you. I am very sympathetic from that standpoint. But, I really would like a little bit more help in terms of getting scores on some of these things and work with you to, again, prioritize what our requests are. Is that fair enough?

Mr. HALL. Sure. Yes.

Chairman JOHNSON. Just two quick final questions. I want to go back a little bit on debt and serviceability of it. Do you have any sense—if you do not, let me know and we will submit it as a question to the record—what our current maturity level is of our current Federal debt versus prior years and what the recommendation would be going forward of trying to extend that, take advantage of these low interest rates? Can you comment on that?

Mr. HALL. I cannot, but I am happy to followup.

Chairman JOHNSON. OK. I think that is pretty important. I would like to see where we used to be, where we are today, because my sense is we have really shortened that maturity time period pretty dramatically to take advantage of these very low short-term interest rates when what we maybe ought to be doing is really trying to go as long as possible without driving up the interest rates themselves by having a great deal of demand.

The other thing, again, this might be picked up in our follow-on hearing on Social Security, but do you know what current law is when we no longer have those bonds and that accounting convention runs out with Social Security benefits? Do you know what actually happens according to current law if we do not do something?

Mr. HALL. Uh——

Chairman JOHNSON. We are facing that with the Social Security Disability Trust Fund——

Mr. HALL. Right.

Chairman JOHNSON [continuing]. In the next year or two, correct?

Mr. HALL. That is right. Yes, that is right. The Disability one is pretty quick. It is fiscal year (FY) 2017. No, I do not know what the current law is on that. I think we sort of assume that money is put in there——

Chairman JOHNSON. Something is going to happen. I have heard, and again, it is very difficult for us—I have heard that, basically, what ends up happening by current law is benefits would be reduced to equal the revenue generation, but I cannot get a real handle on that, so I cannot say that definitively at all, but if you could check on that, we are going to certainly bring in some experts on Social Security to find out what is the law if we just put our heads in the sand on this, which is something I do not recommend we do.

But, again, Dr. Hall, I really do appreciate your testimony, the time you have taken today, and I really, in all sincerity, I want to work with you, because your agency is so critically important to get that information out there for the American public to understand the depth of these issues, because, as Senator Enzi was saying, the sooner you address these problems, the less painful the solutions will be.

So, with that in mind, this hearing record will remain open for 15 days, until July 24, at 5 p.m., for the submission of statements and questions for the record.

This hearing is adjourned.

[Whereupon, at 11:26 a.m., the Committee was adjourned.]

# APPENDIX

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## Opening Statement of Chairman Ron Johnson
### *"Understanding America's Long-Term Fiscal Picture"*
### July 9, 2015

*As submitted for the record:*

Good morning and welcome.

Today's hearing is the first in a series that will focus on describing and defining America's long-term fiscal situation. Over the past week, the world has watched the inevitable next step unfold as Greece is forced to come to terms with the fact that the government benefits promised to Greek citizens exceed its government's ability to pay. No one can predict the end result, but almost everyone admits that Greece's current welfare model is "unsustainable."

"Unsustainable" is a word we have consistently heard from multiple government officials and financial experts in congressional hearings as they describe America's current fiscal path. Few would argue that the current fiscal path is sustainable, and yet very little has been done to address our long-term financial problem. Why?

One reason is that basic human nature often leads to procrastination and the avoidance or denial of unpleasant realities. People prefer to be optimistic and tend to convince themselves that somehow they will be able to conjure up some way out of a bad, or even impossible, situation.

This kind of "can do" attitude is admirable when it results in real solutions. It can be disastrous if it prevents us from taking the first step in solving any problem, which is actually admitting we have one.

Another reason is that for decades, the professional political class has not been honest and forthright with the American public. How many times have we heard – on a bipartisan basis – that Social Security is financially solvent until the year 2033? That may be considered true if we isolate the Social Security trust funds from the federal government as a whole. But it is misleading at best: the trust funds' Treasury bond assets are an offsetting liability to the U.S. Treasury, with a net financial value to the federal government of exactly *zero*.

Or how about statements by the president of the United States that Medicare "only requires modest reforms"? The Urban Institute shows that for every dollar that gets paid into the Medicare systems, three dollars get paid in benefits. As a result, and as we will show today, over the next decade, Medicare is projected to pay out $34 trillion more in benefits than it takes in through payroll tax revenue. When the facts are known, I think most Americans would agree with me that Medicare needs far more than "modest reforms" if it is to be saved for future generations without further mortgaging our children's future.

And that is the objective of today's hearing. What facts must be known, and how do we make those facts as understandable and indisputable as possible to the American people?

As much as I appreciate the Congressional Budget Office's work at developing and publishing long-term financial projections, the fact that so few Americans truly understand the depth of our financial predicament provides strong evidence the information the CBO provides is neither adequately understandable nor effectual. That must change. It is critically important a respected nonpartisan agency be able to accurately describe the depth of our fiscal challenges so voters and policymakers can make fully informed decisions.

To that end I have developed a one-page financial statement for the federal government, as well as the relevant definition and time frame of our 30-year demographic challenge. I offered, and obtained unanimous support for, two amendments to the FY2016 federal budget resolution requiring CBO to provide this information in its published reports. Some progress was made, but more work needs to be done to accomplish the stated objective. I look forward to Director Hall's testimony and will enjoy working with him to provide the American people this important information in a more understandable and relevant format.

###

**Statement of Ranking Member Thomas R. Carper**
*"Understanding America's Long-Term Fiscal Picture"*
July 9, 2015

*As submitted to the record:*

I'd like to thank Chairman Johnson for holding this hearing today, and also welcome our new Congressional Budget Office (CBO) Director Keith Hall to his first appearance before this committee.

Earlier in my career, I served as Delaware State Treasurer to work in a bipartisan way with our Governor and others to address my state's serious budget and financial challenges. We were the best in the country at the time at underestimating savings and overestimating revenues.

Later as Governor, we were able to pass eight balanced budgets in a row. So I share the Chairman's deeply-held interest in these issues, and also his concerns about our long-term fiscal situation at the federal level.

For years, I have championed a three-pronged approach to deficit reduction that I believe would address our long-term budgetary challenges in a comprehensive and balanced way.

First, we must make sensible changes to entitlements that preserve the promise of these programs for generations to come. Next, we need comprehensive tax reform that lowers rates while also raising revenues by broadening the base. And finally, we must look in every nook and cranny of the federal government to find savings for taxpayers.

I once had someone say to me, 'I do not mind paying more taxes. I just don't want you to waste my money.' I think that's a widely held sentiment, and one that this committee has tried to be responsive to over the years.

In looking at our long-term budget picture, there are a couple of points I would like to highlight. The first is that the long-term picture today looks a lot better than it did a few years ago. In 2009, our deficit ballooned to $1.4 trillion following the financial crisis and Great Recession. That was almost 10 percent of GDP at the time.

According to the CBO, our projected deficit for this fiscal year is $486 billion—or 2.7 percent of GDP. I'd like that number to come down even more. However, it's important to note, as CBO has, that 2.7 percent of GDP is identical to the 2.7 percent that deficits have averaged over the past 50 years.

How have we been able to bring the deficit down so much in just a few short years? Economic growth has certainly helped. The private sector has added 12.8 million jobs in the last 64 months. But most significantly, we have confronted the single largest budgetary threat has faced in recent years: the rising cost of health care.

The Affordable Care Act (ACA) has not only expanded health care coverage to millions of uninsured Americans, but has proven to be a significant deficit reduction measure. In fact, CBO recently estimated that repealing the ACA would increase the deficit by over $353 billion over ten years. Repealing ACA in the second decade would add trillions of dollars to the deficit.

The second point I would like to make about the long-term outlook is that Congress is missing some important opportunities that we know will be good for our fiscal health and our economy. For example, CBO estimated that the 2013 Senate-passed comprehensive immigration reform legislation would reduce federal deficits by about $200 billion over the first 10 years, and by about $700 billion in the second decade.

CBO also projected that immigration reform would grow our GDP by as much as five percent over the next 20 years. Yet Congress still hasn't taken action on immigration reform.

Congress also needs to heed long-term projections about the importance of investing in transportation infrastructure.

The McKinsey Global Institute has estimated that the federal, state and local governments must spend at least $150 million billion more a year on infrastructure through 2020 to meet the country's needs and maintain global economic competitiveness. But doing so would also add about 1.5 percent to annual economic growth and create at least 1.8 million jobs. So that would be another win for the economy and our fiscal health.

So, in addressing our long-term fiscal health, Congress undoubtedly has more tough choices ahead. But we also have plenty of opportunity to make smart choices that grow the economy and create jobs.

Again, thank you Chairman Johnson for holding this hearing. Thank you Mr. Hall for being here today, and thanks to the team at CBO that does really outstanding analysis that helps Members of Congress understand the magnitude of the choices that we need to make to put our nation on a long-term path for fiscal stability.

###

Congressional Budget Office

# Testimony

# Understanding the Long-Term Budget Outlook

**Keith Hall**
**Director**

**Before the**
**Committee on**
**Homeland Security and**
**Governmental Affairs**
**United States Senate**

**July 9, 2015**

*This document is embargoed until it is delivered at 10:00 a.m. (EDT) on Thursday, July 9, 2015. The contents may not be published, transmitted, or otherwise communicated by any print, broadcast, or electronic media before that time.*

Chairman Johnson, Senator Carper, and Members of the Committee, thank you for the opportunity to testify on the Congressional Budget Office's assessment of the outlook for the federal budget over the long term. My statement today summarizes *The 2015 Long-Term Budget Outlook*, which CBO released last month.[1]

## Summary

The long-term outlook for the federal budget has changed little since last year, according to CBO's projections. If current laws remained generally unchanged in the future, federal debt held by the public would decline slightly relative to the economy's annual output, or gross domestic product (GDP), over the next few years, CBO projects. After that, however, growing budget deficits—caused mainly by the aging of the population and rising health care costs—would push debt back to, and then above, its current high level. The deficit would grow from less than 3 percent of GDP this year to more than 6 percent in 2040. At that point, 25 years from now, federal debt held by the public would exceed 100 percent of GDP. (Federal debt is now equivalent to about 74 percent of GDP, a higher percentage than at any point in U.S. history except a seven-year period around World War II.)

Moreover, in 2040, debt would still be on an upward path relative to the size of the economy. The rising debt could not be sustained indefinitely; the government's creditors would eventually begin to doubt its ability to cut spending or raise revenues by enough to pay its debt obligations, forcing the government to pay much higher interest rates to borrow money.

One way to measure the long-term fiscal imbalance is to assess the changes in revenues or noninterest spending that would be needed to achieve a chosen goal for federal debt. For example, if lawmakers wanted debt in 2040 to equal its current level of 74 percent of GDP, they could increase revenues or cut noninterest spending, relative to outcomes under current law, by a total of 1.1 percent of GDP each year starting in 2016—an amount equal to $210 billion in that year (see Figure 1). If they chose only to cut noninterest spending, that spending would have to be 5½ percent lower than CBO currently projects in each of the next 25 years. Alternatively, if they chose only to increase revenues, those revenues would have to be 6 percent higher each year than projected. Reducing debt to the average percentage of GDP seen over the past 50 years (38 percent) would require changes in spending or revenues more than twice as large.[2]

Budgetary outcomes are uncertain, however. They would undoubtedly differ from CBO's projections—even if future tax and spending policies matched what is specified in current law—because of unexpected changes in the economy, demographics, and other factors. Nonetheless, CBO's analysis shows that the main implication of this testimony applies under a wide range of possible values for some of those factors. That is, if current laws remained generally unchanged, federal debt, which is already high by historical standards, would probably be at least as high as it is today and would most likely be much higher.

## What Is the Outlook for the Budget in the Next 10 Years?

The economy's gradual recovery from the recession, the waning budgetary effects of policies enacted in response to the weak economy, and other changes to tax and spending laws will cause the deficit to shrink in 2015 to its smallest percentage of GDP since 2007, CBO projects—2.7 percent, a much smaller percentage than the recent peak of nearly 10 percent in 2009.[3] Throughout the next decade, however, an aging population, rising health care costs per person, and an increasing number of recipients of exchange subsidies and Medicaid benefits attributable to the Affordable Care Act would push up spending for some of the largest federal programs if current laws governing those programs remained unchanged (see Figure 2). Moreover, CBO expects interest rates to rebound in coming years from their current unusually low levels, raising the government's interest payments on debt.

1. Congressional Budget Office, *The 2015 Long-Term Budget Outlook* (June 2015), www.cbo.gov/publication/50250.

2. Changes in policy may have macroeconomic effects that feed back into the budget, altering budgetary outcomes. The estimated size of the policy changes just mentioned does not account for such effects.

3. The projections in this testimony are consistent with CBO's March 2015 budget projections after adjustments are made to incorporate the effects of recently enacted legislation. The most important such adjustment was to incorporate the estimated effect of Public Law 114-10, the Medicare Access and CHIP [Children's Health Insurance Program] Reauthorization Act of 2015, which became law on April 16, 2015. For information on the March baseline budget projections, see Congressional Budget Office, *Updated Budget Projections: 2015 to 2025* (March 2015), www.cbo.gov/publication/49973.

**Figure 1.**

**The Size of Policy Changes Needed Over 25 Years to Make Federal Debt Meet Two Possible Goals in 2040**

If Lawmakers Aimed for . . .

| Debt in 2040 to Equal Its 50-Year Average of 38% of GDP . . . | Debt in 2040 to Equal Its Current Level of 74% of GDP . . . |
|---|---|

How Much Would They Need to Increase Revenues or Reduce Noninterest Spending per Year?

| Debt in 2040 to Equal Its 50-Year Average of 38% of GDP | Debt in 2040 to Equal Its Current Level of 74% of GDP |
|---|---|
| **2.6%** of GDP, which is equal to a **14%** ↑ Increase in **Revenues** or **13%** ↓ Cut in **Spending** | **1.1%** of GDP, which is equal to a **6%** ↑ Increase in **Revenues** or **5½%** ↓ Cut in **Spending** |

What Would That Increase in Revenues or Reduction in Noninterest Spending Amount to in 2016?

| Debt in 2040 to Equal Its 50-Year Average of 38% of GDP | Debt in 2040 to Equal Its Current Level of 74% of GDP |
|---|---|
| **$480 billion**, which is equal to **$1,450** per person | **$210 billion**, which is equal to **$650** per person |

What If the Changes Were Increases (of Equal Percentage) in All Types of Revenues?

| Debt in 2040 to Equal Its 50-Year Average of 38% of GDP | | Debt in 2040 to Equal Its Current Level of 74% of GDP |
|---|---|---|
| **+$1,700** | One effect in 2016 is that, on average, **taxes on households** would be higher than under current law. | **+$750** |

Values are for households in the middle fifth of the income distribution.
Those taxes are projected to be $12,300 under current law.

What If the Changes Were Cuts (of Equal Percentage) in All Types of Noninterest Spending?

| Debt in 2040 to Equal Its 50-Year Average of 38% of GDP | | Debt in 2040 to Equal Its Current Level of 74% of GDP |
|---|---|---|
| **-$2,400** | One effect is that **initial Social Security benefits** would be lower than under current law. | **-$1,050** |

Values are averages for people in the middle fifth of the lifetime earnings distribution who were born in the 1950s and who would claim benefits at age 65.
Those benefits are projected to be $18,650 (in 2016 dollars) under current law.

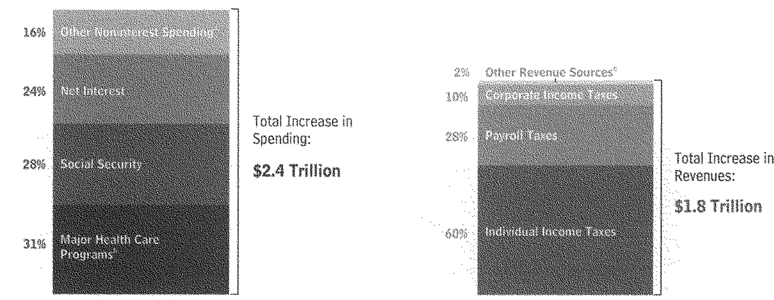
Source: Congressional Budget Office.

Notes: The values shown in this figure are relative to CBO's extended baseline. The extended baseline generally reflects current law, following CBO's 10-year baseline budget projections through 2025 and then extending the baseline concept for the rest of the long-term projection period. The sizes of the policy changes do not account for the macroeconomic feedback of the policies that might be changed or, in the case of the goal to reduce debt to 38 percent of GDP, of the reduction in debt.

GDP = gross domestic product.

**Figure 2.**

**Increases in Spending and Revenues in CBO's Baseline Between 2015 and 2025**




Source: Congressional Budget Office.

a. Consists of all federal spending other than that for the major health care programs, Social Security, and net interest.

b. Consists of spending on Medicare (net of offsetting receipts), Medicaid, the Children's Health Insurance Program, and subsidies offered through health insurance exchanges.

c. Consists of excise taxes, remittances to the Treasury from the Federal Reserve System, customs duties, estate and gift taxes, and miscellaneous fees and fines.

Budget deficits would not substantially increase at first, but eventually they would begin to rise. They would approach 4 percent of GDP toward the end of the 10-year period spanned by CBO's baseline budget projections, the agency anticipates. Deficits over the entire period would total about $7.4 trillion.

With deficits projected to remain close to their current percentage of GDP for the next few years, federal debt held by the public would remain at a very high level, between 73 percent and 74 percent of GDP, from 2016 through 2021. Thereafter, the larger deficits would boost debt—to 78 percent of GDP by the end of 2025.

## What Is the Outlook for the Budget Through 2040?

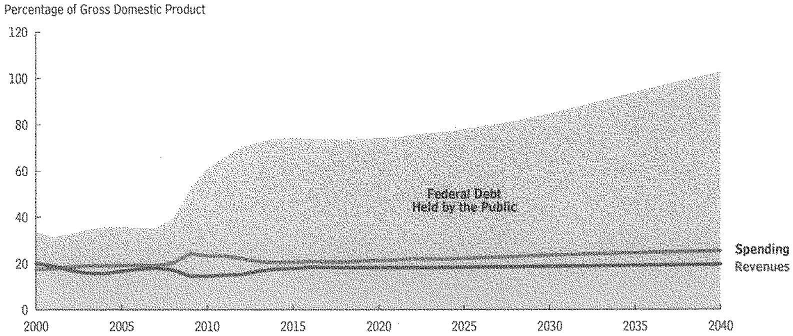
To analyze the state of the budget in the long term, CBO has extrapolated its 10-year baseline projections through 2040, yielding a set of *extended* baseline projections that span a total of 25 years. (Both sets of projections generally incorporate the assumption that current law will not change.) Mainly because of the aging of the population and rising health care costs, the extended baseline projections show revenues that fall well short of spending over the long term, producing a substantial imbalance in the federal budget (see Figure 3). As a result, budget deficits are projected to rise steadily and, by 2040, to raise federal debt held by the public to a percentage of GDP seen at only one previous time in U.S. history—the final year of World War II and the following year (see Figure 4).

The harmful effects that such large debt would have on the economy would worsen the budget outlook. The projected increase in debt relative to the size of the economy, combined with a gradual increase in effective marginal tax rates (that is, the rates that would apply to an additional dollar of income), would make economic output lower and interest rates higher than CBO projected when producing the extended baseline before considering those macroeconomic effects. Those effects would, in turn, feed back into the budget, leading to lower federal revenues and higher interest payments on the debt. (The harm that growing debt would cause to the economy was not factored into CBO's detailed long-term budgetary projections; those effects were projected separately. Therefore, they are generally not reflected in the discussion of the extended baseline elsewhere in this testimony, but they are addressed in Chapter 6 of *The 2015 Long-Term Budget Outlook*.)

**Figure 3.**

## Federal Debt, Spending, and Revenues

Percentage of Gross Domestic Product




Source: Congressional Budget Office.

Note: The extended baseline generally reflects current law, following CBO's 10-year baseline budget projections through 2025 and then extending the baseline concept for the rest of the long-term projection period. These projections do not reflect the macroeconomic feedback of the policies underlying the extended baseline.

In the extended baseline projections, before those feedback effects are considered, federal spending rises from 20.5 percent of GDP this year to 25.3 percent of GDP by 2040 (see Table 1). (Its average over the past 50 years has been 20.1 percent.) The projected increase reflects the following paths for various types of spending:

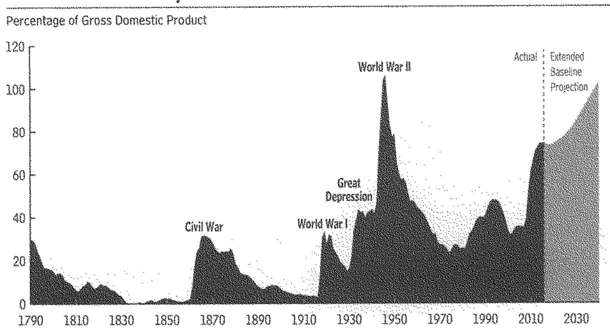
- Federal spending for Social Security and the government's major health care programs—Medicare, Medicaid, the Children's Health Insurance Program, and subsidies for health insurance purchased through the exchanges created by the Affordable Care Act—would rise sharply, to 14.2 percent of GDP by 2040, if current laws remained generally unchanged (see Figure 5 on page 7). That percentage would be more than twice the 6.5 percent average seen over the past 50 years. The boost in spending is projected to occur because of the aging of the population; growth in per capita spending on health care; and, to a lesser extent, an increased number of recipients of exchange subsidies and Medicaid benefits attributable to the Affordable Care Act.
- The government's net outlays for interest would grow to 4.3 percent of GDP by 2040, CBO projects. That percentage would be higher than the 2.0 percent average of the past 50 years, because federal debt would be much larger.
- In contrast, other noninterest spending—that is, spending on everything other than Social Security, the major health care programs, and net interest—would decline to 6.9 percent of GDP by 2040, which would be well below the 11.6 percent average of the past 50 years.

Federal revenues would also increase relative to GDP under current law, but much more slowly than federal spending would. Revenues would equal 19.4 percent of GDP by 2040, CBO projects, which would be higher than the 50-year average of 17.4 percent. That increase would occur mainly because people's income grew more rapidly than inflation, pushing more income into higher tax brackets over time.[4]

4. One consequence is that individual income and payroll taxes as a share of income would grow for many households. For example, a married couple with two children earning the median income in 2014 and filing a joint tax return would have paid about 16 percent of their income in individual income and payroll taxes. Under current law, a similar couple earning the median income 25 years from now would pay about 19 percent of their income in individual income and payroll taxes.

**Figure 4.**

**Federal Debt Held by the Public**




The historically high and rising amounts of federal debt that CBO projects would have significant negative consequences, including reducing the total amounts of national saving and income in the long term; increasing the government's interest payments, thereby putting more pressure on the rest of the budget; limiting lawmakers' flexibility to respond to unforeseen events; and increasing the likelihood of a fiscal crisis.

Source: Congressional Budget Office. For details about the sources of data used for past debt held by the public, see Congressional Budget Office, *Historical Data on Federal Debt Held by the Public* (July 2010), www.cbo.gov/publication/21728.

Note: The extended baseline generally reflects current law, following CBO's 10-year baseline budget projections through 2025 and then extending the baseline concept for the rest of the long-term projection period. These projections do not reflect the macroeconomic feedback of the policies underlying the extended baseline.

By 2040, in CBO's projections that do not account for macroeconomic feedback effects, the deficit equals 5.9 percent of GDP, a higher percentage than in any year between 1947 and 2008 (see Figure 6 on page 8). The resulting debt exceeds 100 percent of GDP in 2040, more than in any year except 1945 and 1946. Under the extended baseline with feedback effects included, CBO's estimate of the deficit in 2040 is higher—6.6 percent of GDP—and so is its estimate of federal debt held by the public: 107 percent of GDP.

The outlook has worsened since 2007 mostly because of the severe economic downturn and significant changes in laws governing federal taxes and spending.[5] In 2007, CBO projected that federal debt held by the public would equal 26 percent of GDP in 2040. By 2010, that projection had risen to 84 percent of GDP, and by 2013 to 105 percent of GDP. (Those projections did not incorporate macroeconomic feedback.)

5. For additional discussion of changes over time in CBO's long-term projections, see Congressional Budget Office, *The 2014 Long-Term Budget Outlook* (July 2014), Appendix C, www.cbo.gov/publication/45471.

CBO typically expresses its long-term projections as percentages of economic output. That approach automatically incorporates inflation and growth in population, output, and income, providing context for understanding the size of the government's activities at different points in time and their effects on the sustainability of the budget.

## What Consequences Would a Large and Growing Federal Debt Have?

How long the nation could sustain such growth in federal debt is impossible to predict with any confidence. At some point, investors would begin to doubt the government's willingness or ability to meet its debt obligations, requiring it to pay much higher interest costs in order to continue borrowing money. Such a fiscal crisis would present policymakers with extremely difficult choices and would probably have a substantial negative impact on the country. Unfortunately, there is no way to predict confidently whether or when such a fiscal crisis might occur in the United States. In particular, as the debt-to-GDP ratio rises, there is no identifiable point indicating that a crisis

**Table 1.**

## Key Projections Under CBO's Extended Baseline

Percentage of Gross Domestic Product

| | 2015 | 2025 | 2040 |
|---|---|---|---|
| | | Without Macroeconomic Feedback[a] | |
| Revenues | | | |
| Individual income taxes | 8.4 | 9.5 | 10.4 |
| Payroll taxes | 5.9 | 5.7 | 5.7 |
| Corporate income taxes | 1.8 | 1.8 | 1.8 |
| Other sources of revenues | 1.7 | 1.2 | 1.5 |
| Total Revenues | 17.7 | 18.3 | 19.4 |
| Spending | | | |
| Mandatory | | | |
| Social Security | 4.9 | 5.7 | 6.2 |
| Major health care programs[b] | 5.2 | 6.1 | 8.0 |
| Other mandatory programs | 2.6 | 2.3 | 1.8 |
| Subtotal | 12.7 | 14.1 | 16.0 |
| Discretionary | 6.5 | 5.1 | 5.1 |
| Net interest | 1.3 | 3.0 | 4.3 |
| Total Spending | 20.5 | 22.2 | 25.3 |
| Deficit | -2.7 | -3.8 | -5.9 |
| Debt Held by the Public at the End of the Year | 74 | 78 | 103 |
| | | With Macroeconomic Feedback | |
| Deficit | -2.7 | -3.8 | -6.6 |
| Debt Held by the Public at the End of the Year | 74 | 78 | 107 |
| **Memorandum:** | | | |
| Social Security[a] | | | |
| Revenues[c] | 4.4 | 4.3 | 4.3 |
| Spending | 4.9 | 5.7 | 6.2 |
| Net increase (-) in deficit | -0.5 | -1.4 | -1.9 |
| Medicare[a] | | | |
| Revenues[c] | 1.5 | 1.6 | 1.7 |
| Spending | 3.5 | 4.4 | 6.3 |
| Offsetting receipts | -0.5 | -0.8 | -1.2 |
| Net increase (-) in deficit | -1.5 | -2.0 | -3.4 |
| Tax Expenditures | 8.1 | n.a. | n.a. |
| Gross Domestic Product (Billions of dollars)[a] | 18,016 | 27,456 | 50,800 |

Source: Congressional Budget Office.

Notes: The extended baseline generally reflects current law, following CBO's 10-year baseline budget projections through 2025 and then extending the baseline concept for the rest of the long-term projection period.

n.a. = not available.

a. These projections do not reflect the macroeconomic feedback of the policies underlying the extended baseline after 2025.

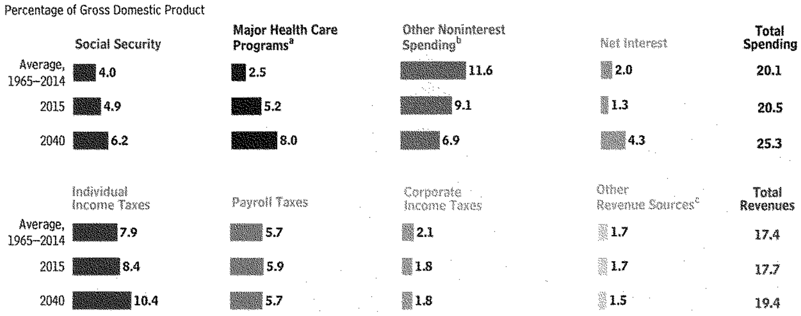
b. Net of offsetting receipts for Medicare.

c. Revenues include payroll taxes other than those paid by the federal government for federal employees, which are intragovernmental transactions. Revenues also include income taxes paid on Social Security benefits, which are credited to the trust funds.

**Figure 5.**

## Spending and Revenues Under CBO's Extended Baseline, Compared With Past Averages

Percentage of Gross Domestic Product




Source: Congressional Budget Office.

Note: The extended baseline generally reflects current law, following CBO's 10-year baseline budget projections through 2025 and then extending the baseline concept for the rest of the long-term projection period. These projections do not reflect the macroeconomic feedback of the policies underlying the extended baseline.

a. Consists of spending on Medicare (net of offsetting receipts), Medicaid, the Children's Health Insurance Program, and subsidies offered through health insurance exchanges.

b. Consists of all federal spending other than that for the major health care programs, Social Security, and net interest.

c. Consists of excise taxes, remittances to the Treasury from the Federal Reserve System, customs duties, estate and gift taxes, and miscellaneous fees and fines.

is likely or imminent. But all else being equal, the larger a government's debt, the greater the risk of a fiscal crisis.[6]

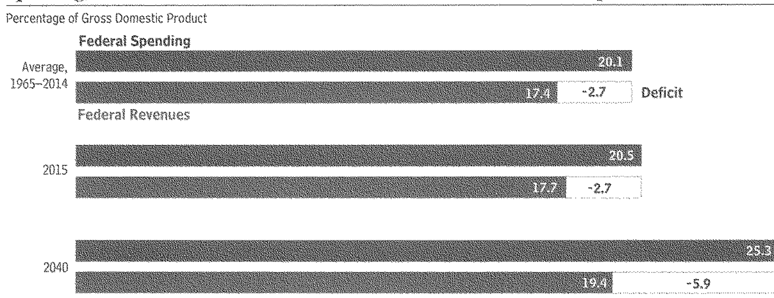
Even before a crisis occurred, the high and rising debt that CBO projects in the extended baseline would have macroeconomic effects with significant negative consequences for both the economy and the federal budget:

- The large amount of federal borrowing would draw money away from private investment in productive capital over the long term, because the portion of people's savings used to buy government securities would not be available to finance private investment. The result would be a smaller stock of capital, and therefore lower output and income, than would otherwise have been the case, all else being equal. (Despite those reductions, output and income per person, adjusted for inflation, would be higher in the future than they are now, thanks to the continued growth of productivity.)
- Federal spending on interest payments would rise, thus requiring the government to raise taxes, reduce spending for benefits and services, or both to achieve any targets that it might choose for budget deficits and debt.
- The large amount of debt would restrict policymakers' ability to use tax and spending policies to respond to unexpected challenges, such as economic downturns or financial crises. As a result, those challenges would tend to have larger negative effects on the economy and on people's well-being than they would otherwise. The large amount of debt could also compromise national security by constraining defense spending in times of international crisis or by limiting the country's ability to prepare for such a crisis.

6. For further discussion, see Congressional Budget Office, *Federal Debt and the Risk of a Fiscal Crisis* (July 2010), www.cbo.gov/publication/21625.

**Figure 6.**

**Spending, Revenues, and Deficits Under CBO's Extended Baseline, Compared With Past Averages**




Source: Congressional Budget Office.

Note: The extended baseline generally reflects current law, following CBO's 10-year baseline budget projections through 2025 and then extending the baseline concept for the rest of the long-term projection period. These projections do not reflect the macroeconomic feedback of the policies underlying the extended baseline.

## How Uncertain Are the Long-Term Budget Projections?

Budget projections are inherently uncertain. The projections in this testimony generally reflect current law—so if future spending and tax policies differ from what is currently prescribed in law, budgetary outcomes will differ from those in CBO's extended baseline. But even if policies do not change, the economy, demographics, and other factors will undoubtedly differ from what CBO projects, and those differences will in turn cause budgetary outcomes to deviate from the projections in this testimony. Those variations could be within the ranges of experience observed in the relevant historical data—which, for the factors that CBO analyzes, cover roughly the past 50 to 70 years—or they might deviate from historical experience. Moreover, there could be significant budgetary effects from channels that CBO does not currently take into account in its estimates.

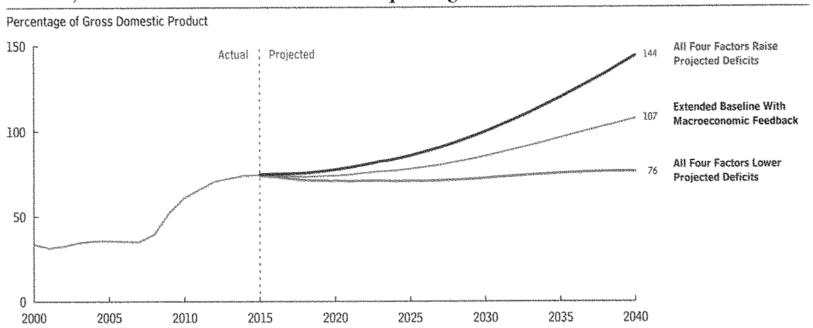
To illustrate some of the uncertainty about long-term budgetary outcomes, CBO has constructed alternative projections showing what would happen to the budget if various underlying factors differed from the values that were used in most of *The 2015 Long-Term Budget Outlook*. The agency focused on four factors that are among the most fundamental and yet most uncertain inputs into the agency's long-term economic and budget projections. Specifically, CBO quantified the consequences of alternative paths for the following variables:

- The decline in mortality rates;
- The growth rate of total factor productivity (that is, the efficiency with which labor and capital are used to produce goods and services);
- Interest rates on federal debt held by the public; and
- The growth rate of federal spending per beneficiary for Medicare and Medicaid.

For CBO's alternative projections, the ranges of variation for those four factors were based on the historical variation in their 25-year averages as well as on consideration of possible future developments, which together offer a guide (though admittedly an imperfect one) to the amount of uncertainty that surrounds projections of those factors over the next 25 years. To better capture overall uncertainty, CBO also constructed two projections in which all four factors simultaneously varied from their values under the extended baseline. In one of those cases, all of the factors varied in ways that increased the

**Figure 7.**

## Federal Debt Given Different Rates of Mortality Decline, Productivity Growth, Interest, and Growth of Federal Health Care Spending




Source: Congressional Budget Office.

Notes: The extended baseline generally reflects current law, following CBO's 10-year baseline budget projections through 2025 and then extending the baseline concept for the rest of the long-term projection period.

Federal debt refers to debt held by the public. Estimates for the extended baseline with macroeconomic feedback are CBO's central estimates from ranges determined by alternative assessments about how much deficits crowd out investment in capital goods such as factories and computers (because a larger portion of private saving is being used to purchase government securities) and about how much people respond to changes in after-tax wages by adjusting the number of hours they work. To arrive at the other two sets of estimates, CBO used rates for four factors that were higher and lower than those used in the extended baseline with macroeconomic feedback by the following amounts: mortality rates, 0.30 percentage points; productivity growth, 0.30 percentage points; interest rates, 0.45 percentage points; and growth of per-beneficiary federal spending on Medicare and Medicaid, 0.45 percentage points.

amount of federal debt; in the other, they varied in ways that reduced the amount of debt.

Different paths for those four factors would affect the budget in various ways. For example, lower-than-projected mortality rates would mean longer average life spans, which would increase the number of people who received benefits from such programs as Social Security, Medicare, and Medicaid; lower mortality rates would also boost the size of the labor force and thereby add to tax revenues (but by less than the increase in benefit costs). Faster growth in spending per beneficiary for Medicare and Medicaid would boost outlays for those two programs. Either of those changes would increase deficits and debt—which would lead to lower output and higher interest rates, macroeconomic feedback that would further worsen the budget outlook. By contrast, faster growth in productivity or lower interest rates on federal debt held by the public would reduce deficits and debt—the former, by raising output and increasing revenues, and the latter, by lowering the government's interest payments.

The projected budgetary outcomes under the alternative paths differ widely. The simulated variations in productivity, interest rates, and Medicare and Medicaid spending have large effects on the budget within 25 years, whereas the simulated variation in mortality rates does not. When only one of the factors is changed, CBO's projections of federal debt held by the public in 2040 range from 89 percent of GDP to 130 percent, whereas debt is projected to be 107 percent under the extended baseline with macroeconomic feedback. When all four factors are changed at once, projections of federal debt in 2040 range from 76 percent to 144 percent of GDP (see Figure 7). Those projected levels of debt are all high by historical standards, and a number of them exceed the peak of 106 percent of GDP that the United States reached in 1946.

The four factors listed above are not the only ones that could differ from CBO's expectations and, in turn, affect the agency's budget projections. For example, an increase in the birthrate or in labor force participation could boost the growth of the labor force and thus raise tax revenues. Similarly, decisions by states about how much they spend on Medicaid could increase or decrease federal spending relative to CBO's projections.

Large disruptions in the economy could have significant effects on the budget that are not quantified in this analysis. The analytic approach that CBO used for this long-term analysis focuses on projecting average outcomes. An economic depression, unexpectedly large losses on federal financial obligations, a large-scale military conflict, the development of a previously underused natural resource, or a major catastrophe—to give just a few examples—could create conditions in the next 25 years that are substantially better or worse than those that produced the historical data on which the analysis is based.

## What Choices Do Policymakers Have?

The unsustainable nature of the federal tax and spending policies specified in current law presents lawmakers and the public with difficult choices. Unless substantial changes were made to the major health care programs and Social Security, spending for those programs would equal a much larger percentage of GDP in the future than in the past. Federal spending as a whole would rise rapidly—even though, under current law, spending for all other federal benefits and services would make up a smaller percentage of GDP by 2025 than at any point in more than 70 years. Federal revenues would also represent a larger percentage of GDP in the future than they have, on average, in the past few decades. Even so, spending would soon start to exceed revenues by increasing amounts relative to GDP, generating rising budget deficits. As a result, federal debt held by the public would grow faster than the economy, starting a few years from now. Because debt is already unusually high relative to GDP, further sustained increases could be especially harmful to economic growth.

To put the federal budget on a sustainable path for the long term, lawmakers would have to make major changes to tax policies, spending policies, or both—by reducing spending for large benefit programs below the projected amounts, letting revenues rise more than they would under current law, or adopting some combination of those approaches. The size of such changes would depend on the amount of federal debt that lawmakers considered appropriate.

For instance, if lawmakers set a goal for 2040 of reducing debt held by the public to the average percentage of GDP seen over the past 50 years (38 percent), one approach would be to increase revenues and cut noninterest spending, relative to outcomes under current law, by a total of 2.6 percent of GDP each year beginning in 2016. That amount would be about \$480 billion, or \$1,450 per person, in 2016 (see Figure 1 on page 2).[7] Many combinations of policies could be adopted to meet that goal, including the following:

- At one end of the spectrum, lawmakers could choose to reduce deficits solely by increasing revenues. Such a policy would require boosting revenues by 14 percent in each year over the 2016–2040 period relative to the amounts that CBO projects in the extended baseline. For households in the middle fifth of the income distribution in 2016, a 14 percent increase in all types of revenues would raise federal tax payments for that year by about \$1,700, on average.

- At the other end of the spectrum, lawmakers could choose to reduce deficits solely by cutting noninterest spending, in which case they would have to make such spending 13 percent lower than projected in the extended baseline in each of the next 25 years. For example, a 13 percent cut would lower initial Social Security benefits by an average of about \$2,400 for people in the middle fifth of the lifetime earnings distribution who were born in the 1950s and who claimed benefits at age 65.

Another goal might be to reduce debt in 2040 to its current percentage of GDP—74 percent. Meeting that goal would require increases in revenues and cuts in noninterest spending, relative to outcomes under current law, totaling 1.1 percent of GDP in each year beginning in 2016.[8] Of course, other goals and other patterns for the timing of savings are possible as well.

7. The estimated size of those policy changes does not account for the macroeconomic effects either of the particular policies that might be changed or of the reduction in debt.

8. The estimated size of those policy changes does not account for the macroeconomic effects of the particular policies that might be changed.

In deciding how quickly to carry out policies to put federal debt on a sustainable path—regardless of the chosen goal for debt—lawmakers would face difficult trade-offs:

- The sooner significant deficit reduction was implemented, the smaller the government's accumulated debt would be; the smaller the policy changes would need to be to achieve the chosen goal; and the less uncertainty there would be about what policies might be adopted. However, precipitous spending cuts or tax increases would give people little time to plan and adjust to those policy changes, and the changes would weaken the economic expansion during the next two years or so—a period when the Federal Reserve would have little ability to lower short-term interest rates to boost the economy.

- Spending cuts or tax increases that were implemented several years from now would have a smaller negative effect on output and employment in the short term. However, waiting for some time before reducing spending or increasing taxes would result in a greater accumulation of debt, which would represent a greater drag on output and income in the long term and increase the size of the policy changes needed to reach the chosen target for debt.

CBO has estimated how much a delay in deficit reduction would increase the size of the policy changes needed to achieve a chosen goal for debt. If the goal was to reduce debt to its 50-year historical average by 2040, but lawmakers waited to implement new policies until 2021, the combination of increases in revenues and reductions in noninterest spending over the 2021–2040 period would need to equal 3.2 percent of GDP—0.6 percentage points more than if policy changes took effect in 2016. If lawmakers chose the same goal but postponed taking action until 2026, the necessary policy changes over the 2026–2040 period would amount to 4.2 percent of GDP.

Even if policy changes that shrank deficits in the long term were not implemented for several years, making decisions about them sooner rather than later could hold down longer-term interest rates, reduce uncertainty, and enhance businesses' and consumers' confidence. Such decisions could thereby make output and employment higher in the next few years than they would have been otherwise.

This testimony summarizes information presented in *The 2015 Long-Term Budget Outlook*, which is one in a series of reports on the state of the budget and the economy that CBO issues each year. That report represents the work of many people at CBO. In accordance with CBO's mandate to provide objective, impartial analysis, this testimony makes no recommendations. It is available on CBO's website at www.cbo.gov/publication/50316.

Keith Hall
Director

# **INCOME STATEMENT** for the federal government: FY**2016** to FY**2045**

Congressional Budget Office's **alternative fiscal scenario**

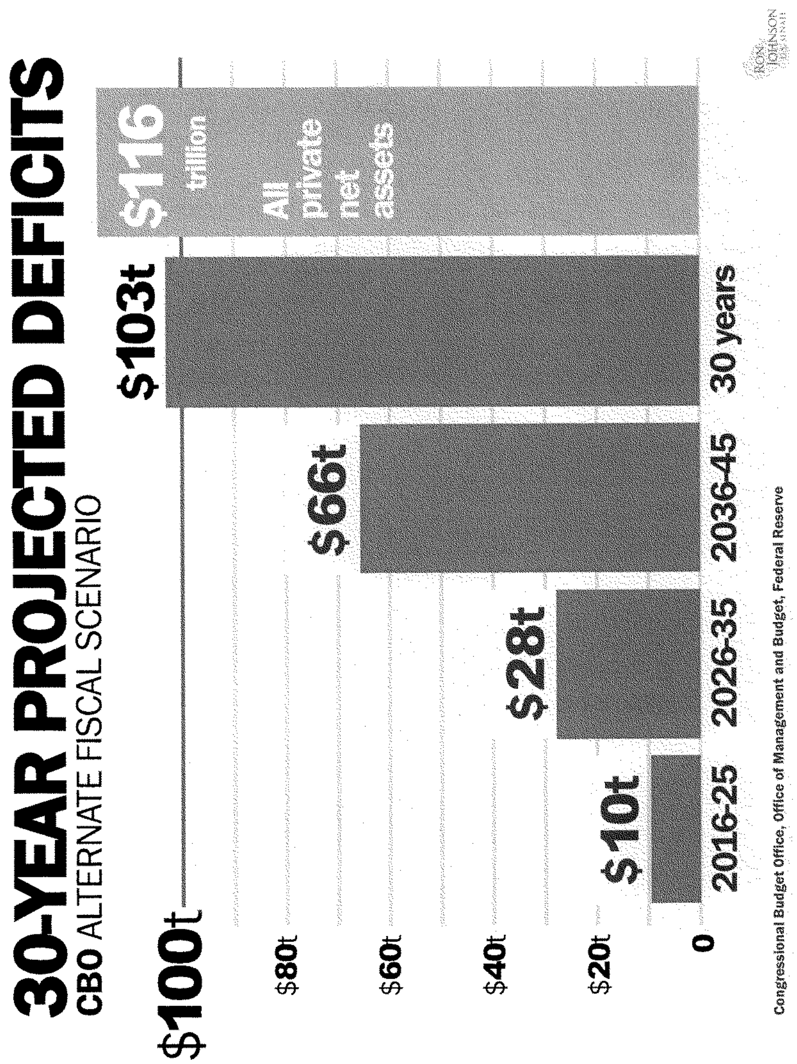
*(dollars in billions)*

| | OUTLAYS | | | | REVENUE | | | | DEFICIT | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | | | *% GDP* | *% total* | | | *% GDP* | *% total* | | | *% GDP* | *% total* |
| Social Security | **$65,284** | | **5.9%** | **21.7%** | **$51,187** | | **4.7%** | **25.8%** | **($14,096 (** | | **1.3%** | **13.7%** |
| Medicare | **49,219** | | **4.5%** | **16.3%** | **15,569** | | **1.4%** | **7.9%** | **(33,650 (** | | **3.1%** | **32.6%** |
| | | **114,503** | **10.4%** | **38.0%** | | **66,757** | **6.1%** | **33.7%** | | **(47,746 (** | **4.3%** | **46.3%** |
| **Outlays:** | | | | | | | | | | | | |
| Defense | **37,151** | | **3.4%** | **12.3%** | | | | | | | | |
| Nondef discretionary | **36,251** | | **3.3%** | **12.0%** | | | | | | | | |
| Medicaid/Obamacare | **29,708** | | **2.7%** | **9.9%** | | | | | | | | |
| Mandatory: other | **28,785** | | **2.6%** | **9.6%** | | | | | | | | |
| Interest expense | **54,982** | | **5.0%** | **18.2%** | | | | | | | | |
| | | **186,876** | **17.0%** | **62.0%** | | | | | | | | |
| **Revenue:** | | | | | | | | | | | | |
| Individual income tax | | | | | **101,935** | | **9.3%** | **51.4%** | | | | |
| Corporate tax | | | | | **17,189** | | **1.6%** | **8.7%** | | | | |
| Excise taxes | | | | | **3,706** | | **0.3%** | **1.9%** | | | | |
| Estate and gift tax | | | | | **1,004** | | **0.1%** | **0.5%** | | | | |
| Custom fees, duties | | | | | **2,496** | | **0.2%** | **1.3%** | | | | |
| Miscellaneous rev | | | | | **5,179** | | **0.5%** | **2.6%** | | | | |
| | | | | | | **131,510** | **12.0%** | **66.3%** | | **(55,367 (** | **5.0%** | **53.7%** |
| **Total rev, outlays, deficit:** | | **301,379** | **27.4%** | **100.0%** | | **198,266** | **18.1%** | **100.0%** | | **(103,113 (** | **9.4%** | **100.0%** |

30-yr GDP: **1,098,100**

Source: CBO, Long-Term Budget Outlook (June 2015)

Note: CBO alt-fisc holds revenue steady at 18.1% of GDP after 2024. CBO provides no source breakdown except for payroll tax components. We extrapolate trends 2020-2025 in individual nonpayroll source as a proportion of nonpayroll projected revenue.


30-YEAR PROJECTED DEFICITS
CBO ALTERNATE FISCAL SCENARIO
$100t
$80t
$60t
$40t
$20t
0
$10t
$28t
$66t
$103t
$116
trillion
All
private
net
assets
2016-25
2026-35
2036-45
30 years
Congressional Budget Office, Office of Management and Budget, Federal Reserve
RON JOHNSON
U.S. SENATE

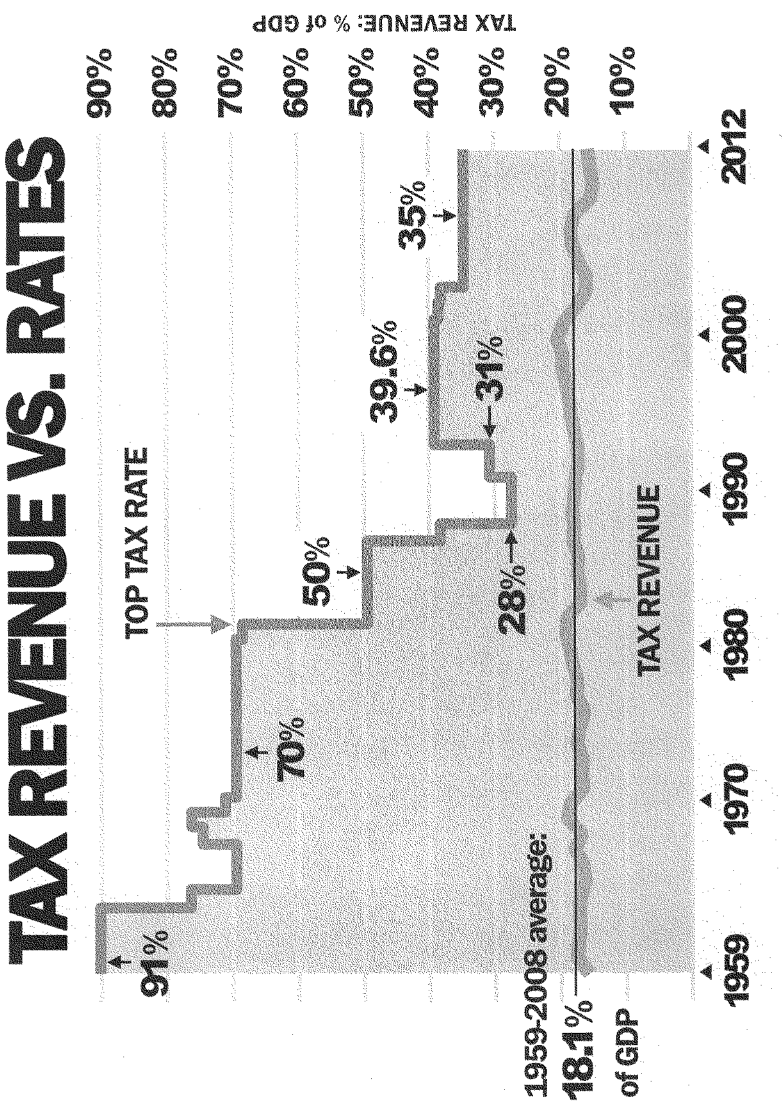
# % OF GDP

## 30-YEAR AVERAGES

| | PRIOR: '85 -'14 | CBO BASELINE | CBO ALT FISC |
|---|---|---|---|
| Social Security: | 4.3 | 5.9 | 5.9 |
| Health care: | 3.4 | 7.2 | 7.2 |
| **Total entitlements:** | **7.7** | **13.1** | **13.1** |
| Defense: | 4.2 | 2.6 | 3.4 |
| Other non-interest: | 6.2 | 4.6 | 5.9 |
| Interest: | 2.2 | 3.7 | 5.0 |
| **Total outlays:** | **20.4** | **24.0** | **27.4** |
| Revenue: | 17.2 | 19.0 | 18.1 |
| **Deficit:** | **3.1** | **5.1** | **9.4** |

**Congressional Budget Office, Office of Management and Budget**

RON JOHNSON U.S. SENATE




Office of Management and Budget, Internal Revenue Service

## Federal revenue as a percent of GDP

| | Revenue | GDP | Rev/GDP (%) | Top tax rate | |
|---|---|---|---|---|---|
| 1945 | 45.2 | 226.4 | **20.0%** | 94 | **avg since 1945** |
| 1946 | 39.3 | 228.0 | 17.2% | 86.45 | **17.2%** |
| 1947 | 38.5 | 238.9 | 16.1% | 86.45 | |
| 1948 | 41.6 | 262.4 | 15.9% | 82.13 | **avg 65-14** |
| 1949 | 39.4 | 276.8 | 14.2% | 82.13 | **17.4%** |
| 1950 | 39.4 | 279.0 | 14.1% | 84.36 | |
| 1951 | 51.6 | 327.4 | 15.8% | 91 | **avg: rates >50%** |
| 1952 | 66.2 | 357.5 | 18.5% | 92 | **17.2%** |
| 1953 | 69.6 | 382.5 | 18.2% | 92 | |
| 1954 | 69.7 | 387.7 | 18.0% | 91 | **avg: rates <50%** |
| 1955 | 65.5 | 407.0 | 16.1% | 91 | **17.2%** |
| 1956 | 74.6 | 439.0 | 17.0% | 91 | |
| 1957 | 80.0 | 464.2 | 17.2% | 91 | |
| 1958 | 79.6 | 474.3 | 16.8% | 91 | |
| 1959 | 79.2 | 505.6 | 15.7% | 91 | |
| 1960 | 92.5 | 535.1 | 17.3% | 91 | |
| 1961 | 94.4 | 547.6 | 17.2% | 91 | |
| 1962 | 99.7 | 586.9 | 17.0% | 91 | |
| 1963 | 106.6 | 619.3 | 17.2% | 91 | |
| 1964 | 112.6 | 662.9 | 17.0% | 77 | |
| 1965 | 116.8 | 710.7 | 16.4% | 70 | |
| 1966 | 130.8 | 781.9 | 16.7% | 70 | |
| 1967 | 148.8 | 838.2 | 17.8% | 70 | |
| 1968 | 153.0 | 899.3 | 17.0% | 75.25 | |
| 1969 | 186.9 | 982.3 | 19.0% | 77 | |
| 1970 | 192.8 | 1,049.1 | 18.4% | 71.75 | |
| 1971 | 187.1 | 1,119.3 | 16.7% | 70 | |
| 1972 | 207.3 | 1,219.5 | 17.0% | 70 | |
| 1973 | 230.8 | 1,356.0 | 17.0% | 70 | |
| 1974 | 263.2 | 1,486.2 | 17.7% | 70 | |
| 1975 | 279.1 | 1,610.6 | 17.3% | 70 | |
| 1976 | 298.1 | 1,790.3 | 16.7% | 70 | |
| 1977 | 355.6 | 2,028.4 | 17.5% | 70 | |
| 1978 | 399.6 | 2,278.2 | 17.5% | 70 | |
| 1979 | 463.3 | 2,570.0 | 18.0% | 70 | |
| 1980 | 517.1 | 2,796.8 | 18.5% | 70 | |
| 1981 | 599.3 | 3,138.4 | 19.1% | 69.125 | |
| 1982 | 617.8 | 3,313.9 | 18.6% | 50 | |
| 1983 | 600.6 | 3,541.1 | 17.0% | 50 | |
| 1984 | 666.4 | 3,952.8 | 16.9% | 50 | |
| 1985 | 734.0 | 4,270.4 | 17.2% | 50 | |
| 1986 | 769.2 | 4,536.1 | 17.0% | 50 | |
| 1987 | 854.3 | 4,781.9 | 17.9% | 38.5 | |
| 1988 | 909.2 | 5,155.1 | 17.6% | 28 | |
| 1989 | 991.1 | 5,570.0 | 17.8% | 28 | |
| 1990 | 1,032.0 | 5,914.6 | 17.4% | 28 | |
| 1991 | 1,055.0 | 6,110.1 | 17.3% | 31 | |
| 1992 | 1,091.2 | 6,434.7 | 17.0% | 31 | |
| 1993 | 1,154.3 | 6,794.9 | 17.0% | 39.6 | |
| 1994 | 1,258.6 | 7,197.8 | 17.5% | 39.6 | |
| 1995 | 1,351.8 | 7,583.4 | 17.8% | 39.6 | |
| 1996 | 1,453.1 | 7,978.3 | 18.2% | 39.6 | |
| 1997 | 1,579.2 | 8,483.2 | 18.6% | 39.6 | |
| 1998 | 1,721.7 | 8,954.8 | 19.2% | 39.6 | |
| 1999 | 1,827.5 | 9,510.5 | 19.2% | 39.6 | |
| 2000 | 2,025.2 | 10,148.2 | **20.0%** | 39.6 | |
| 2001 | 1,991.1 | 10,564.6 | 18.8% | 39.1 | |
| 2002 | 1,853.1 | 10,876.9 | 17.0% | 38.6 | |
| 2003 | 1,782.3 | 11,332.4 | 15.7% | 35 | |
| 2004 | 1,880.1 | 12,088.6 | 15.6% | 35 | |
| 2005 | 2,153.6 | 12,888.9 | 16.7% | 35 | |
| 2006 | 2,406.9 | 13,684.7 | 17.6% | 35 | |
| 2007 | 2,568.0 | 14,322.9 | 17.9% | 35 | |
| 2008 | 2,524.0 | 14,752.4 | 17.1% | 35 | |
| 2009 | 2,105.0 | 14,414.6 | 14.6% | 35 | |
| 2010 | 2,162.7 | 14,798.5 | 14.6% | 35 | |
| 2011 | 2,303.5 | 15,379.2 | 15.0% | 35 | |
| 2012 | 2,450.0 | 16,026.4 | 15.3% | 35 | |
| 2013 | 2,775.1 | 16,581.6 | 16.7% | 39.6 | |
| 2014 | 3,021.5 | 17,244.0 | 17.5% | 39.6 | |

OMB: fy2016 historical tables. Table 1.3 and 10.1

### *Alt-fisc scenario*

| | Revenue | GDP | Rev/GDP (%) |
|---|---|---|---|
| 2015 | 3,150.0 | 18,000 | **17.5%** |
| 2016 | 3,365.2 | 18,800 | 17.9% |
| 2017 | 3,526.3 | 19,700 | 17.9% |
| 2018 | 3,666.8 | 20,600 | 17.8% |
| 2019 | 3,809.2 | 21,400 | 17.8% |
| 2020 | 3,969.4 | 22,300 | 17.8% |
| 2021 | 4,147.4 | 23,300 | 17.8% |
| 2022 | 4,325.4 | 24,300 | 17.8% |
| 2023 | 4,528.7 | 25,300 | 17.9% |
| 2024 | 4,752.0 | 26,400 | 18.0% |
| 2025 | 4,977.5 | 27,500 | 18.1% |
| 2026 | 5,176.6 | 28,600 | 18.1% |
| 2027 | 5,393.8 | 29,800 | 18.1% |
| 2028 | 5,611.0 | 31,000 | 18.1% |
| 2029 | 5,846.3 | 32,300 | 18.1% |
| 2030 | 6,081.6 | 33,600 | 18.1% |
| 2031 | 6,316.9 | 34,900 | 18.1% |
| 2032 | 6,588.4 | 36,400 | 18.1% |
| 2033 | 6,859.9 | 37,900 | 18.1% |
| 2034 | 7,131.4 | 39,400 | 18.1% |
| 2035 | 7,439.1 | 41,100 | 18.1% |
| 2036 | 7,746.8 | 42,800 | 18.1% |
| 2037 | 8,072.6 | 44,600 | 18.1% |
| 2038 | 8,434.6 | 46,600 | 18.1% |
| 2039 | 8,796.6 | 48,600 | **18.1%** |
| 2040 | 9,194.8 | 50,800 | 18.1% |
| 2041 | 9,611.1 | 53,100 | 18.1% |
| 2042 | 10,027.4 | 55,400 | 18.1% |
| 2043 | 10,479.9 | 57,900 | 18.1% |
| 2044 | 10,950.5 | 60,500 | 18.1% |
| 2045 | 11,439.2 | 63,200 | 18.1% |

### *Extended baseline*

| | Revenue | GDP | Rev/GDP |
|---|---|---|---|
| 2015 | 3,186.0 | 18,000 | 17.7% |
| 2016 | 3,459.2 | 18,800 | 18.4% |
| 2017 | 3,605.1 | 19,700 | 18.3% |
| 2018 | 3,728.6 | 20,600 | 18.1% |
| 2019 | 3,873.4 | 21,400 | 18.1% |
| 2020 | 4,036.3 | 22,300 | 18.1% |
| 2021 | 4,217.3 | 23,300 | 18.1% |
| 2022 | 4,398.3 | 24,300 | 18.1% |
| 2023 | 4,604.6 | 25,300 | 18.2% |
| 2024 | 4,804.8 | 26,400 | 18.2% |
| 2025 | 5,032.5 | 27,500 | 18.3% |
| 2026 | 5,233.8 | 28,600 | 18.3% |
| 2027 | 5,483.2 | 29,800 | 18.4% |
| 2028 | 5,735.0 | 31,000 | 18.5% |
| 2029 | 6,007.8 | 32,300 | 18.6% |
| 2030 | 6,249.6 | 33,600 | 18.6% |
| 2031 | 6,526.3 | 34,900 | 18.7% |
| 2032 | 6,843.2 | 36,400 | 18.8% |
| 2033 | 7,163.1 | 37,900 | 18.9% |
| 2034 | 7,446.6 | 39,400 | 18.9% |
| 2035 | 7,809.0 | 41,100 | 19.0% |
| 2036 | 8,174.8 | 42,800 | 19.1% |
| 2037 | 8,563.2 | 44,600 | 19.2% |
| 2038 | 8,947.2 | 46,600 | 19.2% |
| 2039 | 9,379.8 | 48,600 | 19.3% |
| 2040 | 9,855.2 | 50,800 | 19.4% |
| 2041 | 10,354.5 | 53,100 | 19.5% |
| 2042 | 10,858.4 | 55,400 | 19.6% |
| 2043 | 11,406.3 | 57,900 | 19.7% |
| 2044 | 11,979.0 | 60,500 | 19.8% |
| 2045 | 12,576.8 | 63,200 | 19.9% |

CBO: Long-Term Budget Outlook

**The Size of Policy Changes Needed Over 25 Years to Make Federal Debt Meet Two Possible Goals in 2040**

If Lawmakers Aimed for . . .

**Debt** in 2040 to Equal Its 50-Year Average of **38%** of GDP . . .

**Debt** in 2040 to Equal Its Current Level of **74%** of GDP . . .

How Much Would They Need to Increase Revenues or Reduce Noninterest Spending per Year?

**2.6%** of GDP, which is equal to a **14%** Increase in **Revenues** **or** **13%** Cut in **Spending**

**1.1%** of GDP, which is equal to a **6%** Increase in **Revenues** **or** **5½%** Cut in **Spending**

What Would That Increase in Revenues or Reduction in Noninterest Spending Amount to in 2016?

**$480 billion**, which is equal to **$1,450** per person

**$210 billion**, which is equal to **$650** per person

What If the Changes Were Increases (of Equal Percentage) in All Types of Revenues?

+$1,700

One effect in 2016 is that, on average, **taxes on households** would be higher than under current law.

+$750

Values are for households in the middle fifth of the income distribution. Those taxes are projected to be $12,300 under current law.

What If the Changes Were Cuts (of Equal Percentage) in All Types of Noninterest Spending?

-$2,400

One effect is that **initial Social Security benefits** would be lower than under current law.

-$1,050

Values are averages for people in the middle fifth of the lifetime earnings distribution who were born in the 1950s and who would claim benefits at age 65. Those benefits are projected to be $18,650 (in 2016 dollars) under current law.

Source: Congressional Budget Office. (Summary Figure 1 from *The 2015 Long-Term Budget Outlook* [June 2015]), www. cbo.gov/publication/50250)

Notes: The values shown in this figure are relative to CBO's extended baseline. The extended baseline generally reflects current law, following CBO's 10-year baseline budget projections through 2025 and then extending the baseline concept for the rest of the long-term projection period. The sizes of the policy changes do not account for the macroeconomic feedback of the policies that might be used to achieve the goals or, in the case of the goal to reduce debt to 38 percent of GDP, of the reduction in debt.

GDP = gross domestic product.