Transcript of Remarks by Senate Budget Committee Chairman Kent Conrad (D-ND) at Hearing on Outlook for the Economy and Fiscal Policy with Congressional Budget Office Director Douglas Elmendorf September 28, 2010

Opening Statement:

I want to thank my colleagues and thank our witness for being here. Today's hearing will focus on the outlook for the economy and fiscal policy. Our witness today is CBO Director Doug Elmendorf. Director Elmendorf, welcome back. We look forward to your testimony.

I would note that this is our third hearing on the economy in the last two months. We have heard from six outstanding economists so far. Director Elmendorf will make it seven.

Let me begin by providing an overview of our fiscal and budget outlook. I think it is critically important to remember the economic crisis we faced just a short time ago. By mid- to late-2008, we were in the midst of the worst recession since the Great Depression. The economy shrunk at a rate of 6.8 percent in the fourth quarter of 2008. Unemployment was surging, with 800,000 private-sector jobs lost in January 2009 alone. A housing crisis was rippling through the economy, with homebuilding and home sales plummeting and record foreclosures. And we faced a financial market crisis that threatened to set off a global economic collapse.

I will never forget being called to an emergency meeting in the Leader's office in the fall of 2008. I arrived at about six o'clock. There were the leaders of Congress, Republicans and Democrats, Senate and the House, the Chairman of the Federal Reserve, the Secretary of the Treasury in the previous administration. And they told us they were taking over AIG the next morning. They believed if they did not, there would be a financial collapse. Those were very, very serious days.

The federal response to the crisis, I believe, has successfully pulled the economy back from the brink. And this year, we have begun to see a return to economic and job growth, although both are weaker than we would hope.

Two of our witnesses from last week's hearing, Dr. Blinder and Dr. Zandi, completed a study that measures the impact of the federal response to the crisis. I would like to highlight their findings and then ask Dr. Elmendorf to comment in his testimony on whether CBO has found a similar impact and result.

Dr. Blinder and Dr. Zandi's report said in part, and I quote: "We find that its effects on real GDP, jobs, and inflation are huge, and probably averted what could have been called Great Depression 2.0.... When all is said and done, the financial and fiscal policies will have cost taxpayers a substantial sum, but not nearly as much as most had feared and not nearly as much as if policymakers had not acted at all. If the comprehensive policy responses saved the economy from another depression, as we estimate, they were well worth their cost."

This chart compares the jobs we have actually had in our economy recently with an estimate of the jobs we would have had without the federal response. It shows that we would have had 8.1 million fewer jobs in the second quarter of 2010 if we had not had the federal response.

We see a similar picture with the unemployment rate. The actual unemployment rate, on a quarterly basis, is now hovering at about 9.7 percent. This is still far too high and we must do more to create jobs and bring this rate down. But if we had not had the federal response, the unemployment rate would now be 15 percent and – this is according to the analysis by Dr. Blinder and Dr. Zandi – and would continue rising to 16.2 percent by the fourth quarter of 2010.

So clearly, the federal response to the economic crisis has had, and continues to have, a significant positive impact on the economy.

But clearly we are not out of the woods. The economy remains unsteady and faces strong headwinds. That is why, in the near-term, I believe we need to focus on providing additional liquidity to boost demand and promote job creation. We cannot afford to repeat the mistake of the mid-1930's, when recovery measures were pulled back too quickly and the Great Depression was prolonged.

At my request, CBO has previously provided Congress with a ranking of the "bang for the buck" we get from various federal policies designed to spur economic growth. This chart depicts some of the policy options ranked by CBO. On the upper end of the scale, it shows that policies like extending unemployment insurance and providing payroll tax relief for firms hiring unemployed workers give you a higher impact on GDP for each dollar spent.

Also at my request, CBO has now done further refinements of these rankings to help Congress as it considers options going forward. I look forward to hearing from Director Elmendorf about CBO's latest findings in this area.

In addition to the near-term economic challenge, we must also confront the looming long-term budget crisis. The retirement of the baby boom generation, rising health care costs, and our outdated and inefficient tax system are projected to explode deficits and debt in the years ahead. I might say that if we extend all the tax cuts permanently, that would have a profound effect on increasing deficits and debt as well.

According to CBO, federal debt could rise to 400 percent of gross domestic product by 2054 – that is 44 years from now. That is a completely unsustainable course.

What we should be doing now is putting in place deficit reduction policies that will kick in after the economy has more fully recovered. By establishing and enacting these policies now, we will reassure the financial markets that the United States is confronting its long-term fiscal imbalances.

Let me just conclude with what Chairman Bernanke has said earlier this year about the need for a credible plan to address our long-term fiscal challenges. He said, and I quote: "… A sharp near-term reduction in our fiscal deficit is probably neither practical nor advisable. However, nothing prevents us from beginning now to develop a credible plan for meeting our long-run fiscal challenges. Indeed, a credible plan that demonstrated a commitment to achieving long-run fiscal sustainability could lead to lower interest rates and more rapid growth in the near term."

I believe that. That is why I believe the work of the President's fiscal commission is so important. As members of that commission, Senator Gregg and I can attest to the hard work being done by the commission. I remain hopeful that we will come up with a bipartisan plan that puts the nation back on track.

Excerpted Q&A Discussion with Director Elmendorf:

Chairman Conrad:

So let's go to the question of the tax cuts, because that is one of the key issues Congress will confront when we return. As I analyze the results of your work, it is that although they are pretty modest with respect to bang for the buck, extension of the tax cuts would be positive in the short-term – 2011 and 2012 – but actually be negative in the long-term. That is, permanent extension of the tax cuts, all of them, would actually be the most negative in terms of its effect on economic growth in the long-term. Is that correct?

Director Elmendorf:

...[O]f the tax options that we studied – the four different ways of extending the expiring tax provisions – the permanent extensions would have the largest negative effect on national income over the longer run. The largest boost in the short-run, as you have said, but the largest negative effect in the long-run. That would occur because the extra government borrowing from the significantly larger deficits would drag down income more than the extra work effort or savings that would be generated by the lower tax rates.

Chairman Conrad:

So the effect of tax cuts, which many of us associate as being positive with respect to economic growth, is your conclusion is, in the short-term, additional tax cuts, extending the tax cuts, expiring provisions, would be positive, although the least positive of the policies that you have looked at in terms of effect on the economy, it would give us the least bang for the buck, but longer-term, the tax cuts are actually harmful to economic growth because they are deficit financed. Is that correct?

Director Elmendorf:

Yes. That is correct, Mr. Chairman.

Chairman Conrad:

So that really creates a conundrum, because we have two things that kind of work against each other here. On the one hand, we have a series of policies that have been rated in terms of bang for the buck, extending the tax cuts is among the weakest in terms of helping boost economic growth, although it is positive. So extending tax cuts would have a mildly positive effect short-term, but it would have a negative effect long-term, because they are deficit financed, just as additional spending would help us short-term, but be negative long-term.

Director Elmendorf:

Yes, that's right. The effects are really rather symmetric in that way. We have written on a number of occasions that the source of policies that lead to short-term boost, higher government spending or lower taxes, if not accompanied by other offsetting changes over time, just allowed to increase deficit and debt over time, will have negative effects in the medium- and long-run.

Chairman Conrad:

Let me just say for many people it is counter-intuitive that tax cuts could somehow hurt future economic growth. How is that? Why is it that in your analysis tax cuts could be actually harmful to long-term economic growth?

Director Elmendorf:

I think the natural intuition is people thinking about their own situations, and thinking correctly that if their tax rates were lower, that would give them an incentive to work more, to save more, to invest more. And that is right as far as it goes. The problem is that if those tax cuts are not accompanied by other changes in the government budget, and are simply funded through borrowing, that that borrowing crowds out other private investment in productive capital in the sorts of equipment, the computers, the machinery, the buildings, that are the source of long-term economic growth. And that connection is less visible, and I think thus is less apparent in most people's intuition, but it is no less important for being not so visible, for being more indirect.

Chairman Conrad:

I think that is incredibly important testimony that you have given us today. I hope people are listening because what I hear you saying is, short-term, anything we do to provide stimulus, whether it is increased spending or additional tax cuts, would give you a short-term boost, but either of them, additional spending over what is projected or additional tax cuts, will actually hurt longer-term economic growth, because the impact of the deficits and debt will serve like a weight around the neck of the economic engine of this country.

Additional Conrad Comment:

It is very clear we are going to have to cut spending as a share of the economy. It is also clear to me we cannot afford to make permanent all of the tax cuts that are currently in the code – which kind of jumps out at you that what we need is tax reform. The tax code is now 75-hundred pages long, and it was never designed with competitiveness in mind. The world has changed since that tax code was written. And if we don't write a new tax code that relates to the reality we confront today, that we are in a fully competitive global environment, if we don't write a tax code with that in mind, I think we are making a profound mistake. Just to double-down on this current tax code would be just a huge mistake.