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Testimony of Peter R. Orszag,
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Chairman Rangel, Ranking Member Camp, and Members of the Committee, thank you for inviting me to testify this afternoon about the President's Fiscal Year 2011 Budget.

I come before you after a trying year for the Nation. One year ago, the economy seemed on the verge of a severe collapse, perhaps leading to a second Great Depression. Together with the Congress, the President worked aggressively to stabilize the financial system and bring the economy back from the brink. The worst now appears to be behind us. However, the country faces two significant and ongoing challenges: high unemployment and a medium- and long-term fiscal situation that will ultimately undermine future job creation and economic growth. It took years to create the current jobs gap and our budget deficits, and it is our responsibility to start addressing them without delay.

Rescuing and Rebuilding the Economy

Let me start by reviewing where we have been.

A little more than a year ago, in the fourth quarter of 2008, real GDP was declining at a rate of more than 5 percent per year. In that quarter alone, household net worth fell by almost $5 trillion, dropping at a rate of 30 percent a year. In terms of employment, the fourth quarter saw a loss of 1.7 million jobs—the largest quarterly decline since the end of World War II and a number only to be exceeded by the next quarter when 2.1 million jobs were lost.

This bleak economic picture was reflected in the trillion dollar gap between how much the economy had the potential to produce and how much it was actually producing. Last year, for example, this output gap of roughly $1 trillion represented nearly 7 percent of the estimated potential output of the economy. This "GDP gap" motivated enactment of the American Recovery and Reinvestment Act (the Recovery Act) just 28 days after we took office, to start filling this hole and jumpstart the economy.

The Recovery Act contains three parts. Approximately one-third is dedicated to tax cuts for small businesses and 95 percent of working families. Another third goes toward emergency relief for those who have borne the brunt of the recession. For example, more than 17 million Americans have benefited from extended or increased unemployment benefits, and health insurance was made 65 percent less expensive for laid-off workers and their families relying on COBRA. In addition, aid to State, tribal, and local governments has helped them to close budget shortfalls, saving the jobs of hundreds of thousands of teachers, firefighters, and police officers. The final third of the Recovery Act is devoted to investments to create jobs, spur economic activity, and lay the foundation for future sustained growth.

Over the past year, the evidence suggests that the Recovery Act has made a substantial difference. Estimates—from the Council of Economic Advisers, as well as respected private forecasters such as Goldman Sachs and Mark Zandi of Moody's Economy.com—suggest that the legislation added roughly three percentage points to economic activity in the third quarter. The result is that, as 2010 opens, the U.S. economy is back from the brink. Financial markets are far more stable, and real GDP is expanding.

Although real GDP growth has turned positive, American businesses were still shedding jobs in the third and fourth quarters. The unemployment rate was 10.0 percent in December 2009, and there are 7 million fewer jobs than when the recession began in December 2007. While there are some early indicators of labor market improvement, such as rising productivity and the hiring of temporary workers, there is much left to do.

The increase in unemployment has had devastating effects on American families. Far too many workers who would rather be earning a paycheck are forced to accept unemployment, and are worrying about how to pay their mortgage, keep their health insurance, and continue to provide for their families while they try to find another job. As the President has said, the coming months will continue to be difficult ones for American workers, and, regardless of the GDP numbers, the recovery will not be real for most Americans until the job market turns around.

This is why, in the short term, it is critical that we take steps to jumpstart job creation in the private sector. And that is why the Administration will work with Congress to implement a jobs creation package along the lines of what the President announced in December 2009. It should include:

- *Help for small businesses to expand investment, hire workers, and access credit.* Small businesses play a crucial role in a dynamic economy. The Administration is calling for expansions or extensions of Recovery Act tax relief for small businesses that will encourage investment and job growth, along with a new, short-term tax incentive to encourage small business hiring and support employment. More than 1 million small businesses will receive a tax cut from this latter proposal, which will extend a $5,000 tax credit to small businesses for every new job they add in 2010 and will also reimburse them for the Social Security payroll taxes they pay on real increases in their payrolls this year.

- *Investments in America's roads, bridges, and infrastructure.* The Administration is also calling for new investments in a wide range of infrastructure, designed to get out the door as quickly as possible and continue a sustained effort at creating jobs and improving America's productivity. And we support financing infrastructure investments in new ways, allowing projects to be selected on merit, as was done through the Recovery Act's TIGER program, and leveraging money with a combination of grants and loans.

- *Investments in energy efficiency and clean energy.* The Administration is seeking a new program to provide rebates for consumers who make energy efficiency retrofits; such a program will harness the power of the private sector to help drive consumers to make cost-saving investments in their homes. We are also calling for expansion of successful, oversubscribed Recovery Act programs to leverage private investment in energy efficiency and create clean energy manufacturing jobs.

In addition to these priority investments, the Administration supports immediate steps to lend additional help to those most affected by the recession. The Budget therefore proposes to extend emergency assistance to seniors and families with children, unemployment insurance benefits, COBRA tax credits, and relief to States, Indian tribes, and localities to prevent layoffs. And the Budget also extends tax relief to 95 percent of working families through an additional year of the Making Work Pay tax credit.

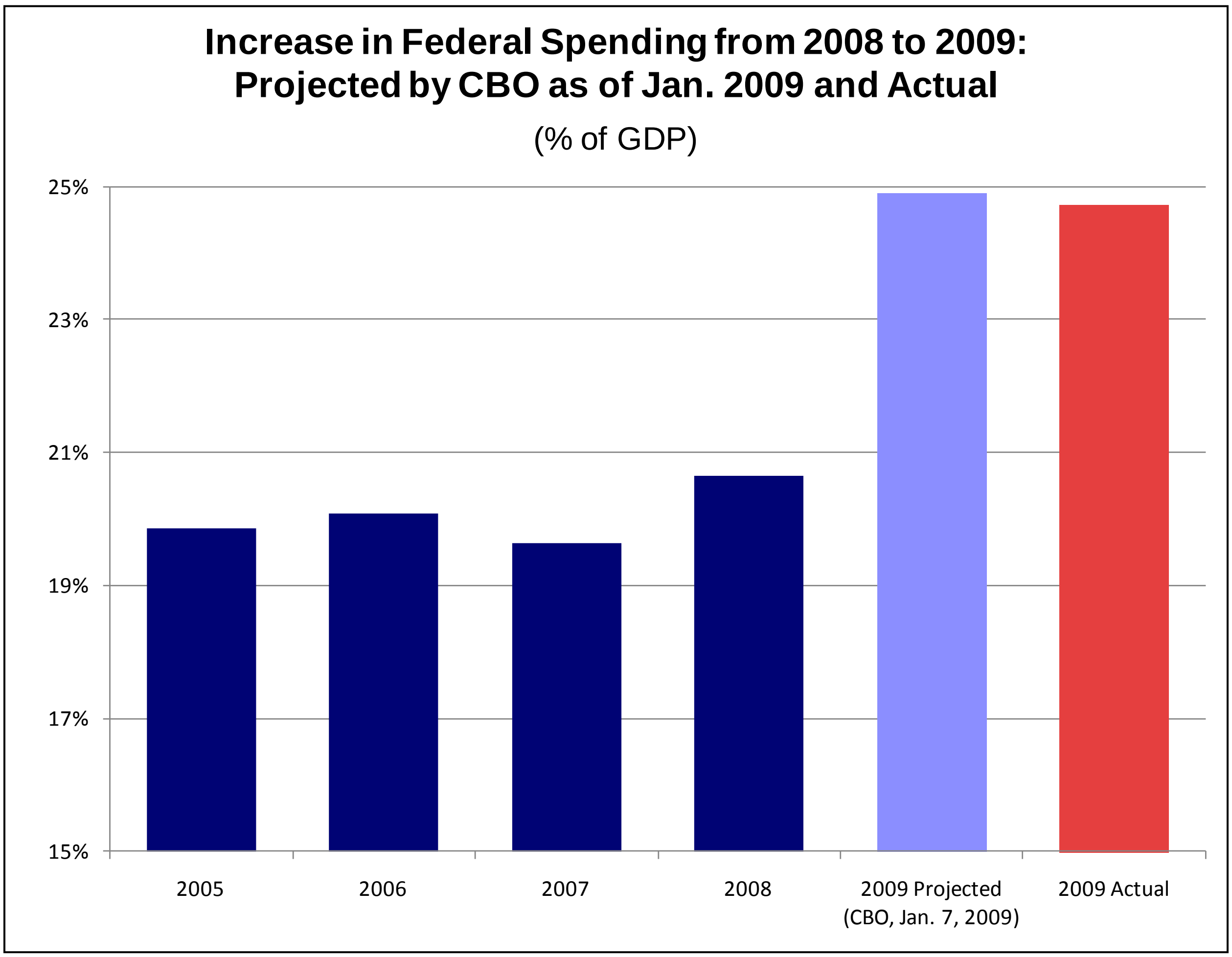
Restoring Fiscal Discipline

Unfortunately, we face not just this jobs deficit but also a substantial fiscal deficit. On the day the Administration took office, the budget deficit for 2009 stood at $1.3 trillion, or 9.2 percent of GDP—higher than in any year since World War II. And, over the following ten years, projected deficits totaled $8 trillion.

Short-term deficits

The deficit increased substantially in fiscal year 2009, which began on October 1, 2008. Given the depth of the economic downturn in late 2008, an increase in the deficit as we entered 2009 was to be expected—and, indeed, such an increase was temporarily desirable because it increased aggregate demand in the economy. (During a recession, the key to economic growth is the demand for the goods and services the economy could produce with existing capacity—and in that situation, temporary increases in the deficit are beneficial to help put the economy back on track.) The increase in the deficit during 2009 reflected a decline in revenue and an increase in spending, both of which were primarily linked to the economic downturn and both of which were already apparent before the Administration took office.

For example, on January 7, 2009, the Congressional Budget Office (CBO) issued its Economic and Budget Outlook for Fiscal Years 2009-2019. In that document, CBO projected that government spending would rise from 20.9 percent of GDP in fiscal year 2008 to 24.9 percent of GDP in fiscal year 2009. In reality, government spending in fiscal year 2009 turned out to be roughly what had been predicted a year earlier (24.7 percent), according to CBO's updated Economic and Budget Outlook issued in January of this year. (The mix of spending was slightly different from what CBO had initially projected, with somewhat lower mandatory spending and somewhat higher discretionary spending as a share of the economy.)



Medium-term deficits

In addition to the 2009 deficit, the Administration also inherited an $8 trillion ten-year deficit. Even these figures, moreover, understate the fiscal shortfall the Administration actually inherited for the next decade. As of last winter, the depth of the current recession was not yet fully apparent. Since we released our Budget overview last February, the deterioration in our economic and technical assumptions added another $2 trillion to the deficit through 2019, as it became clear that we were in the midst of the worst recession since the Great Depression.

As a result, without changes in policy, deficits would total $10.6 trillion over the next ten years—and would fall from their current levels to an average of about 5 percent of GDP in the second half of the decade.

This unsustainable starting point largely reflects three factors: a failure to pay for policies in the past, the impact of the economic downturn, and the steps we took to mitigate that downturn.

- More than half of these deficits can be linked to the previous Administration's failure to pay for the 2001/2003 tax cuts and the prescription drug bill. Over the next ten years, these two unpaid-for policies are slated to add $5.8 trillion to the deficit, including interest expense on the additional associated debt. Put differently, if these two policies had been paid for, projected deficits—without any further deficit reduction—would be about 2 percent of GDP per year by the middle of the decade, and we would have been on a sustainable medium-term fiscal course.

- The recession that began in December 2007 also adds considerably to the projected deficits. When the economy enters a recession, the Federal Government's receipts automatically fall and the costs for certain programs, such as unemployment insurance, automatically rise. Over the next ten years, these automatic stabilizers are projected to add about $2.4 trillion to the deficit, including interest expense.

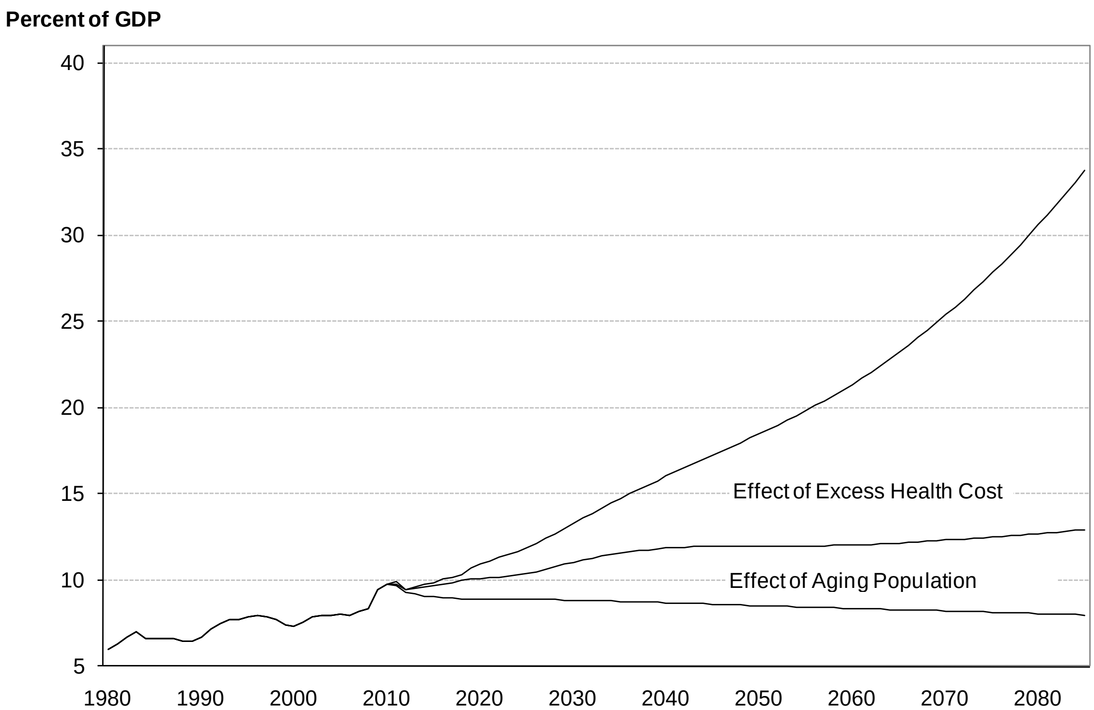
- Finally, it is worth noting that the Recovery Act—which, as discussed, has been key to restoring economic growth—plays a relatively small role in the projected deficits compared to these other costs. Over the next ten years, the deficit impact of the Recovery Act is less than one-tenth the size of the costs associated with 2001/2003 tax cuts, the prescription drug bill, and the automatic effects of the recession on the Federal budget.

Summed together, this fiscal legacy—the unpaid-for 2001/2003 tax cuts and prescription drug bill, as well as the worst recession since the Great Depression and our necessary response to it—accounts for $9 trillion of the projected deficits under current policies. They are the reason that our medium-term deficits are on an unsustainable course.

Long-term deficits

As our horizon extends beyond the next decade, the role of health care costs in driving our budget deficits becomes more prominent. The figure below shows the projected growth of Medicare, Medicaid, and Social Security spending over the next 75-years, assuming historical excess cost growth continues. This illustrates that we are on an unsustainable path. Within the next half century, spending on these three programs is projected to exceed 20 percent of GDP, more than double their current share of the economy. The fact remains that we cannot close the long-term fiscal shortfall without slowing the rate of health care cost growth. Reducing excess cost growth by 15 basis points (0.15 percentage points) generates more savings than closing the entire Social Security deficit over the next 75 years.

Sources of Projected Growth in Medicare, Medicaid, and Social Security



Policies to Reduce the Deficit and Restore Responsibility

That is how these projected deficits over the next decade arose and how our long-term fiscal future is dominated by health care costs. But whatever their cause, our future prosperity may be threatened if we do not address our medium- and long-term fiscal trajectory. So what are we doing?

First, we have already taken action to ensure that we do not make the hole any deeper. The Administration proposed and Congress is on the verge of enacting statutory pay-as-you-go (PAYGO) legislation. PAYGO forces us to live by a simple but important principle: Congress can only spend a dollar on an entitlement increase or tax cut if it saves a dollar elsewhere. In the 1990s, statutory PAYGO encouraged the tough choices that helped move the Government from large deficits to surpluses, and it can do the same today. To repeat what I have already said, the failure of the previous administration to abide by the PAYGO principle accounts for over $5 trillion of our projected deficits. And, while both houses of Congress had already taken an important step toward righting our fiscal course by adopting congressional rules incorporating the PAYGO principle, enacting statutory PAYGO will strengthen enforcement and redouble our commitment.

The President's Budget represents another important step toward fiscal sustainability. The Budget reduces deficits by $1.2 trillion over the next 10 years—not including savings associated with our presumed ramp-down of operations in Iraq and Afghanistan. If those savings are included, deficit reduction under our Budget comes to $2.1 trillion. Furthermore, the President's Budget cuts the inherited deficit in half as a share of GDP by the end of the President's first term,

The deficit reduction steps include:

- *Imposing a three-year freeze on non-security discretionary funding*. Over the past year, a surge in Federal spending has helped to bolster macroeconomic demand, while also funding long-needed investments that are helping to build a new foundation for economic growth. But, as the economy recovers, we need to rebalance our spending priorities, as we transition from jumpstarting the economy to restoring fiscal sustainability. That is why the President's Budget proposes a three-year freeze in non-security discretionary funding (that is, discretionary funding outside of defense, homeland security, veterans affairs, and international affairs), with funding thereafter increasing roughly with inflation. The proposed freeze in non-security discretionary funding from 2010 to 2011 is well below the 5 percent average growth in such funding since the early 1990s. And over the next 10 years, this policy saves $250 billion relative to continuing the 2010 funding levels for these programs adjusted for inflation.

  The non-security discretionary freeze allows some agency budgets to expand even while others are constrained, and expands some investments while curtailing others. Education, job training, and R&D provide vivid examples. Sound investments in education are crucial to building the skills and productivity of the Nation's current and future workers. Even while expanding funding overall and significantly expanding the successful Race to the Top competition, the President's Budget will eliminate 6 discretionary programs and consolidate 38 K-12 programs into 11 new initiatives that emphasize competition in allocating funds. This will give communities more choices around activities and hold grantees accountable for results.

And to keep Americans building new and competitive skills throughout their working lives, the Budget provides $19 billion for job training and employment programs Government-wide, a $1.1 billion, or 6 percent, increase from 2010. This level includes two new innovation funds that will test and evaluate new approaches to training disconnected youths, building regional partnerships, and supporting apprenticeships. The Budget will also support a ten-year extension of Trade Adjustment Act assistance for American workers who have lost their jobs due to imports or shifts in production overseas, and provide additional support for training in green jobs.

Similarly, R&D is a cornerstone of a thriving economy, and the Budget features $61.6 billion for civilian research and development—an increase of $3.7 billion, or 6.4 percent, over 2010 levels. But while continuing the commitment to double funding for three key basic research agencies—the National Science Foundation, the Department of Energy's Office of Science, and the National Institute of Standards and Technology—the Budget also eliminates programs that are not effectively achieving their goals. For example, the Budget cancels NASA's Constellation program, which was intended to return astronauts to the Moon by 2020, but has run severely behind schedule and over-budget. In place of Constellation, the Budget proposes to leverage international partnerships and commercial capabilities to set the stage for a revitalized human space flight program, while also accelerating work—constrained for years due to the budget demands of Constellation—on climate science, green aviation, science education, and other priorities.

- *Requiring the financial services industry to fully pay back the costs of the Troubled Asset Relief Program (TARP).* Assisting the financial services industry was necessary to prevent an even worse financial meltdown—and even greater repercussions throughout the entire economy. But this step rewarded firms that had taken excessive and unreasonable risks. While the Administration's sound management of the TARP program has caused its expected cost to fall by $224 billion since the 2010 Mid-Session Review to about $117 billion, shared responsibility requires that the largest financial firms pay back the taxpayer as a result of the extraordinary action taken. Congress recognized this when it wrote the legislation authorizing TARP by requiring the President to propose a way for the financial sector to pay the costs of the program. The Administration is therefore calling for a Financial Crisis Responsibility Fee on the largest Wall Street and financial firms that will last at least 10 years, but longer if necessary, to compensate the taxpayers fully for the extraordinary support—both direct and indirect—that they provided. This fee would be limited to financial firms with over $50 billion in assets. As it would be based on an institution's size and exposure to debt, it would also further the Administration's financial reform goals by encouraging firms to reduce their size and leverage—which were two major contributors to the financial crisis.

- *Allowing the 2001-2003 tax cuts for households earning more than $250,000 to expire*. The Budget proposes allowing most of the 2001/2003 tax cuts to expire in 2011, as scheduled, for those families making more than $250,000 ($200,000 for single individuals). The additional revenues gained would be devoted to deficit reduction. These tax cuts were unaffordable at the time they were enacted, and remain so today. The Budget would simply return the marginal tax rates for these wealthiest Americans to what they were prior to 2001. Altogether, allowing these tax cuts to expire would save $678 billion over the next ten years relative to current policy.

- *Limiting the rate at which itemized deductions can reduce tax liability to 28 percent for families with incomes over $250,000.* Currently, if a middle-class family donates a dollar to its favorite charity or spends a dollar on mortgage interest, it gets a 15-cent tax deduction, but a millionaire who does the same enjoys a deduction that is more than twice as generous. By reducing this disparity and returning the high-income deduction to the same rates that were in place at the end of the Reagan Administration, the Budget raises $291 billion over the next decade.

- *Eliminating funding for inefficient fossil fuel subsidies.* As we work to create a clean energy economy, it is counterproductive to spend taxpayer dollars on incentives that run counter to this national priority. To further this goal and reduce the deficit, the Budget eliminates tax preferences and funding for programs that provide inefficient fossil fuel subsidies and undermine efforts to deal with carbon pollution. The Budget proposes eliminating 12 tax breaks for oil, gas, and coal companies, closing loopholes to raise nearly $39 billion over the next decade.

Health Insurance Reform

In addition to these specific policies to address the medium-term deficit, the Administration has also faced head-on the primary driver of our long-term fiscal shortfall—rising health care costs. Both the House and Senate health insurance reform legislation would not only reduce the deficit over the next decade as scored by the non-partisan CBO, but perhaps more importantly would create an infrastructure that would help to improve quality and constrain costs over the long term.

Both bills would aggressively test different approaches to delivering health care and move toward paying for quality rather than quantity. In the Recovery Act, we took steps toward greater quality at lower cost by making historic investments in health information technology and research into which treatments work and which do not. Comprehensive health insurance reform would build on these investments by providing tools and incentives for physicians, hospitals, and other providers to improve quality. For example, by bundling payments and establishing accountable care organizations, as well as by creating disincentives for dangerous and unnecessary re-admissions and health-facility acquired infections, physicians and hospitals will be induced to redesign their systems, coordinate care to keep people healthy, and avoid unnecessary complications

It is also vital that reform include a Medicare commission—composed of doctors and other health care experts—that can enable the health system to keep pace with innovation and the dynamic health care marketplace. The commission will help to make sure that reforming the health care system is not a one-time event, but rather an ongoing process over time, creating a continuous feedback loop where we generate more and better information about what is working in the health care delivery system and then rapidly bring those initiatives to scale. Lastly, reform should include an excise tax on the highest-cost insurance plans. The proposed tax on "Cadillac" health insurance plans will do more than help pay for reform; it will curtail the growth of private health insurance premiums—by providing employers with an incentive to seek higher-quality and lower-cost health benefits that will generate higher take-home pay for American workers and their families. In other words, the excise tax will help to slow health care cost growth and thereby also give Americans a pay raise.

Congress must now deliver on this promise of fiscally responsible health reform—the stakes are high, both for the millions of Americans who lack a stable source of health insurance coverage and for the fiscal wellbeing of the Nation itself. I echo the President's commitment last week to hear any and all ideas for a better approach to fiscally responsible health reform, and I also echo his challenge to Congress that it must not walk away from comprehensive reform with the finish line so near.

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Taken together, the more than $1 trillion in deficit reduction proposed by our Budget represents an important step toward fiscal responsibility over the medium term, and the health legislation under consideration would help to reduce deficits over the longer term.

Fiscal Commission

The President has now proposed two budgets that reduce outyear deficits. But the Administration is not yet satisfied. Even with this substantial deficit reduction, we will still face unsustainable medium- and long-term deficits.

The only way to solve the remainder of our fiscal challenge is to solve it in a bipartisan fashion. That's why the President has called for the creation of a bipartisan Fiscal Commission to identify policies to improve the fiscal situation in the medium term and to achieve fiscal sustainability over the long run.

Specifically, in addition to addressing our long-term fiscal imbalance, the Commission is charged with balancing the budget excluding interest payments on the debt by 2015. This result is projected to stabilize the debt-to-GDP ratio at an acceptable level once the economy recovers. The magnitude and timing of the policy measures necessary to achieve this goal are subject to considerable uncertainty and will depend on the evolution of the economy. In addition, the Commission will examine policies to meaningfully improve the long-run fiscal outlook, including changes to address the growth of entitlement spending and the gap between the projected revenues and expenditures of the Federal Government.

Conclusion

The policies we have enacted in the last year and those proposed in the President's Budget seek to restore economic and fiscal health after years of poor decisions. While we have much work left to do to accomplish this goal, our economic freefall has been stopped; financial markets have calmed; and the Recovery Act returned our economy to growth in the third quarter of last year. On the fiscal front, the President's Budget puts on the table more than $1 trillion in deficit reduction over the next ten years by imposing historic restraint on the growth of non-security discretionary funding and restoring fairness and balance to the tax code.

These are key steps forward, but they are not enough. Although the rate of job loss has slowed dramatically, job gain has not yet begun, and the Administration will not be satisfied until the many Americans seeking work can find it. Moreover, while our Budget significantly reduces projected deficits, they remain undesirably high.

The Administration is committed to addressing these challenges facing our Nation, and I look forward to working with you in the weeks and months ahead to do so.