USING FISCAL POLICY TO BOLSTER THE U.S. ECONOMY

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BEFORE THE

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TUESDAY, JANUARY 29, 2008

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

The committee met, pursuant to call, at 10:05 a.m., in room 210, Cannon House Office Building, Hon. John Spratt [chairman of the committee] presiding.

Present: Representatives Spratt, DeLauro, Edwards, Cooper, Kaptur, Becerra, Doggett, Blumenauer, Etheridge, Ryan, Garrett, Hensarling, and Conaway.

Chairman SPRATT. I call the hearing to order, and the first order of business is to recognize that we have a birthday among us. My colleague, Mr. Ryan, has reached the ripe old age of 38 years. Happy birthday, Paul.

Mr. RYAN. Thank you, Chairman. I'm still 4 months younger than Brett Favre. Mr. Chairman, thank you.

Chairman SPRATT. Well, good morning to everyone, and excuse my voice, but I've got a terrible cold. Welcome to the Budget Committee's hearing on the economy and what we can do to improve the prospects of near-term growth.

We are pleased to have a panel of very distinguished economists to testify today. It includes Larry Summers, the former Secretary of the Treasury; Alice Rivlin, the founding Director of the Congressional Budget Office, and former Deputy Director of OMB; Bob Greenstein, the Executive Director of the Center on Budget and Policy Priorities; and Brian Wesbury, Chief Economist of First Trust Advisors.

This hearing comes in response to warnings issued last December by Larry Summers and Marty Feldstein. Dr. Summers not only pointed to troubling conditions in the economy; he outlined a solution and suggested three Ts as our criteria for seeking such a solution: that it be timely, targeted and temporary.

The need for countercyclical measures to shore up the economy was underscored by Marty Feldstein in testifying before this committee and reiterated by Chairman Bernanke and by CBO Director Orszag in hearings before this committee.

Chairman Bernanke painted a worsening picture of current conditions and affirmed the need for fiscal stimulus to complement the monetary issues of the Federal Reserve. Dr. Bernanke and Dr. Orszag both projected a slowdown in growth but came short of predicting a recession. CBO's economic forecast, however, has grown more pessimistic since August, resulting in higher deficits in 2008 and a 10-year forecast that has worsened by $850 billion.

Going straight to the bottom line, we have taken heed of your warnings. Later today, the House will take up bipartisan stimulus legislation that is consistent with the criteria suggested by Dr. Summers. It is timely. It is targeted. It is temporary. I hope very much that the House gives its overwhelming approval to this bill and sends it to the Senate, in which it is passed.

This agreement is a practical step to boost the economy, to bolster consumer confidence and to give relief to millions of hard-working Americans where it is needed most. As with any compromise, no one got everything that he or she wanted in this package, but it is critical to get a bill enacted quickly, in order to help the economy and people who are hurting, without undue delay. I can name features that I would very much like to add to the bill, but expedition, I believe, is more important than any of them. I think that their coming to the floor is probably the best agreement we can strike with the Bush administration if we want the stimulus to come quickly and be effective.

Over the weeks ahead, the Congress will continue to advance proposals to improve our security and strengthen the fiscal fundamentals. In light of the dismal economic news in the 2009 budget resolution, we would appreciate your thoughts on the following questions: Where are we now? How did we get here? And where are we headed?

Dr. Summers, we will ask you to lead off as the lead witness, but before turning to you for testimony, I want to recognize Mr. Ryan for his opening remarks.

Mr. Ryan.

Mr. RYAN. Thank you, Chairman.

Chairman Spratt, you're three for three. Once again, today's hearing is both right on topic and extremely well-timed, so I congratulate you for yet another interesting, well-timed hearing.

Just last week, the House leadership and the administration announced agreement on a bipartisan economic stimulus package. However, I understand that the Senate may move to alter that package with added spending. So today's hearing is an excellent opportunity for this committee to review the relative merit of various growth proposals.

First, we have got to take a realistic look at the so-called "stimulus package" and make sure we don't overestimate its effects. We must recognize the limits of the Federal Government's ability, particularly that of Congress, to address the immediate economic concerns at hand. Admittedly, I'm somewhat skeptical that Congress can get it right.

These "stimulus packages," which are the subject of the vagaries of the legislative process, tend to bear a much closer resemblance to a blunt instrument than the fine precision tool we pretend them to be.

Even if we move quickly to enact this current growth package, for example, most analysts say the checks would go out around May or June in the third quarter. By then, the economic slowdown we seem to be experiencing could be over, at least according to current projections.

I agree that letting taxpayers keep more of their own money that they've earned is a very good idea, especially now when it can provide a brief financial cushion at a time of high gas prices, high home heating prices and others. But at best, I think this action will have a small, short-lived impact.

This package is clearly not a substitute for good economic policy. The key to long-term growth lies in expanding our economy's productive capacity, not in simply propping up short-term demand by giving up resources the economy has already produced. For sustained economic growth, we need low tax burdens, a stable rate of inflation, an attractive investment climate, and a dynamic labor force. Growth also requires tax certainty so that American businesses and families can plan for the future.

Finally, we have got to recognize that we simply cannot spend our way to prosperity. Congress will be tempted to use the excuse of "fiscal stimulus" to push through a wish list of new spending, and I compliment House leadership and the administration for resisting this temptation. It is ironic to hear increased government spending touted as a cure for our economic ills when it is unsustainable growth in government spending, particularly that of our entitlement programs, that pose the greatest threat to our Nation's long-term economic growth and prosperity. While there are risks to the short-term economic growth outlook, we need to balance these risks with the actions we take.

I hope today's hearing will shed more light on the economic outlook and the effectiveness of steps to address these concerns about a weaker economy, and I thank the Chairman for his well-timed hearing.

Chairman SPRATT. Thank you, Mr. Ryan.

Before proceeding, as a matter of housekeeping, I would like to ask unanimous consent that all members be allowed to submit an opening statement for the record at this point.

And let me say a brief apology to Dr. Rivlin. I believe you were the Director of OMB, not just the Deputy Director. But, for the record, I want to recognize you for that.

Let's proceed, then, with Dr. Summers.

Dr. Summers, as with all the witnesses, your prefiled written testimony will be made part of the record. You can summarize it as you see fit. Thank you for coming. We look forward to hearing from you.

STATEMENT OF LAWRENCE H. SUMMERS, PH.D., CHARLES W. ELIOT UNIVERSITY PROFESSOR, HARVARD UNIVERSITY

Mr. SUMMERS. Mr. Chairman, thank you very much for the opportunity to appear before this distinguished committee at this important juncture. Let me make three points.

First, the most likely course for the American economy now appears to be that the economy will go into recession during 2008. In that context, fiscal stimulus is appropriate. There is the possibility, though very much not a probability, that with an inadequate policy response, a recession could be protracted as a vicious cycle starts in which financial strains lead to reduced spending, which leads to a weaker economy, which leads to increased financial strains, which leads to a weaker economy and so forth, creating a vicious cycle. This risk is present and makes action appropriate.

Second, the actions—the proposed stimulus package agreed by the congressional leadership—House leadership and the President meets the necessary criteria for fiscal stimulus. It is, given the circumstances, timely; and, I might say to many, it came as a very pleasant surprise how rapidly that agreement was reached. And one hopes that the momentum from that will be confirmed today when the House votes, and in the very near future as this moves forward in the Senate.

It is, for the most part, appropriately targeted in directions that are likely to spur spending and cause the money to be injected into the economy as rapidly as possible; and, appropriately, it is temporary and focused on the near-term issue of providing stimulus. There is no possible improvement in this package that would warrant a substantial delay in its passage.

That said, like everyone else, I would prefer to see changes in the package, but proposed changes are very much subordinate to the imperative of rapid action.

The two changes that I would most like to see are the inclusion of an expansion in unemployment insurance benefits, which, in my judgment, would respond appropriately to the fact that we have very substantial levels of long-term unemployment today, that the unemployed are the people who are likely to spend money most rapidly upon its receipt so as to have maximum impact, and the increases in benefit levels can take place even more rapidly than the provision of tax rebates.

The second change I would like to see, which would make it possible to pay for the first change within the current budget envelope, would be the modification of the proposed business tax breaks to operate on an incremental basis. The business tax break of accelerated depreciation has as its motivation that it will encourage the rescheduling of investment from 2009 or 2010 into 2008 when that investment is most needed. If the incentive was provided not for all investment in 2008, but only for investment above two-thirds of last year's investment, or above depreciation, or above some form of benchmark, as is done with the R&D tax credit, exactly the same incentive would be provided at a cost of only about a third as great to the fisc, making it possible to expand rebates or to expand unemployment insurance.

Both of these steps would, in my judgment, make for a better package, but neither is worth substantial delay in the current context.

Third and finally, Mr. Chairman, I would emphasize that the danger of recession and the appropriateness of stimulus as a response to that recession should not blind anyone. It especially should not blind members of this committee to the very substantial, long-run fiscal problems that this country continues to face.

At the root of many of our economic difficulties is our low level of national saving, and at the root of our low level of national saving is the activities that take place in the Federal budget. It is not unreasonable to project—given the various items such as the AMT, such as increased war costs not included in the standard Congressional Budget Office baseline and the reality that the Congressional Budget Office has estimated—that recessions typically lead to reduced revenues and increased expenditures that would at the current scale of the economy amount to extra costs of $150 to $300 billion or more; that in the event of the recession that is likely to materialize, we will within a couple of years be facing budget deficits that could be $500 billion or more.

This is a very tentative forecast, and it could easily not materialize. But it highlights the importance of regarding the nonuse of PAYGO as something that is very specific and appropriate to this fiscal stimulus package at this moment, but it underscores the importance for the remainder of this year and, I would suggest, the likely importance at the beginning of next year of this committee focusing, as it has so often in the past, on the long-term health of our budget.

Thank you very much, Mr. Chairman.

Chairman SPRATT. Thank you very much, Dr. Summers.

[The prepared statement of Lawrence Summers follows:]

Prepared Statement of Lawrence H. Summers, Charles Eliot University Professor, Harvard University

I am grateful for the opportunity to testify before this committee at this important juncture. I admire last week's efforts by the President, the Treasury Secretary, and both parties of the House to reach a deal on a stimulus package that is timely, targeted, and temporary. A similar urgency in the Senate this week will hopefully produce the stimulus this economy requires and will help average Americans to get through this period of economic uncertainty. Here I answer six questions concerning the major issues at stake in the debate over fiscal stimulus, and then provide my views on the stimulus agreement reached last week. While I will attempt to provide the most definitive answers as of this moment, the best policy response may change as we receive new economic data and as our understanding of the current, highly volatile economic situation improves.

1. WHAT IS THE CURRENT ECONOMIC OUTLOOK?

Following the instability in global markets last week and recent economic reports—particularly the last employment report and retail sales data—my judgment, like that of many economists, is that a recession is more likely than not. Even if there is not an officially defined recession, there is almost certain to be a significant slowdown in the economy that will feel like a recession in many parts of the country and to many businesses and families. Moreover given the extraordinary fragility observed in financial markets at present, there is a risk of a dangerous situation developing in which financial strains create a weakening economy which in turn creates financial strains. Such a vicious cycle if not preempted could lead to a recession considerably worse than what we observed in in either 2001 or the early 1990s. In this context the preponderant economic risks are of recession and financial instability rather than inflation and asset price bubbles.

2. WHY NOT RELY ON MONETARY POLICY TO STIMULATE THE ECONOMY AND FOCUS FISCAL POLICY ON LONGER TERM ISSUES?

As Chairman Bernanke has recognized, monetary policy has an essential role to play in maintaining demand and growth as well as in combating financial instability. In the current context, however, it is best complemented by fiscal policy for a variety of reasons: (i) in normal times fiscal policy is faster acting than monetary policy, and given the financial problems it may be even more true today. (ii) proper fiscal policies can target the innocent victims of recession and can directly promote job creation, (iii) full reliance on monetary policy could easily mean lowering interest rates to levels that would be problematic for the dollar, commodity prices, future asset bubbles and moral hazard, and (iv) in a situation where policy impacts are uncertain it is most prudent to rely on a diversified set of stimulus measures. The Federal Reserve's unprecedented 75-basis-point intermeeting reduction constitutes an important step, but the goal of alleviating the likelihood of a recession—and moderating a recession if we do experience one—will be best achieved by complementing monetary policy with a fiscal stimulus. Failure to build on the progress made in the last weeks towards an agreed stimulus plan would be a significant blow to market confidence and economic prospects.

3. HOW GREAT IS THE RISK OF OVERHEATING THE ECONOMY AND CAUSING INFLATION? SHOULD A DECISION ON FISCAL STIMULUS AWAIT DEFINITIVE EVIDENCE THAT THE ECONOMY IS IN RECESSION?

The balance of risks is now on the side of recession rather than inflation. Inflation measured by personal consumption expenditures excluding food and energy was 1.9 percent over the last year. Measures of inflation expectations as inferred from Treasury indexed bonds are close to their lowest point in the last two years. Moreover, in a climate of great uncertainty about workers' jobs and firms' profit margins inflation pressures are more likely to diminish than increase. Increases in inflation that have been observed recently reflect to a significant extent the impact of developments in oil as well as other commodity markets as well as declines in the dollar. Even if they are not reversed, these markets are unlikely have as large an inflationary impact in the future as in the recent past.

There is sufficient weakness in the economy to justify stimulus legislation now with provision for rapid implementation. Studies of past experiences with stimulus reveal that too often stimulus comes too late. The risks of excessive delay given lags in implementation and effect are much greater than the risks of premature stimulus. If stimulus were to be excessive any highly speculative risks of overheating the economy could be offset by the Fed. On the other hand, allowing recessionary forces to build could be very dangerous as financial and real economic problems reinforced each other.

4. HOW LARGE SHOULD A STIMULUS PACKAGE BE?

In December, I advocated stimulus in the range of $50-$75 billion. Given recent data, I now believe that it would be appropriate to enact a program of this magnitude as soon as possible and to make provision for a second tranche of about the same magnitude. While as recently as a few weeks ago, I would have favored some tranching of additional fiscal stimulus, adverse developments have been sufficient that I now believe that enacting a full package at once is the best course of action.

Sizing a stimulus package cannot be reduced to hard science. Given the deterioration in the economy that has taken place in recent months a package with a total cost of 1% of GDP would run very little danger of overheating the economy on any plausible scenario. If delivered in the second and third quarters of 2008 it could have a material impact on consumers and on confidence more generally.

5. WHAT SHOULD COMPRISE A STIMULUS PACKAGE?

As with any potent medicine, stimulus, if misadministered, could do more harm than good by increasing instability and creating long run problems.

A stimulus program should be timely, targeted and temporary.

Timely stimulus requires both that Congress and the President act quickly and that measures be chosen which can be implemented rapidly and which will have their ultimate impact on spending in short order. This puts a premium on simple measures that work through existing modalities, such as adjustment of withholding schedules, tax refunds, or enhancements of benefits. It calls into question the wisdom of designing new programs or using approaches where Federal spending is not injected fairly directly into the economy. When past stimulus efforts have failed, the major problem has been that they have come too late.

Given the Olympic analogies that been infused into this election cycle in recent weeks, a medal system may be an appropriate rubric for quantifying the relative timeliness of various stimulus packages. A gold medal would go to legislation passed in the first quarter of this year, with its impact realized in the second and third quarters. A silver medal could be awarded for any legislation passed in the second quarter, with impact realized within the year. But because this is an Olympics of a different sort, no medal would be awarded for legislation enacted beyond the second quarter that does not have an impact this year.

Targeted stimulus requires that funds be channeled where they will be spent rapidly and where they will reach those most in need. This also argues for use of simple changes in withholding schedules, or tax refunds, as well as for changes in benefit formulas. In general, targeting in both the sense of assuring maximum spending and fairness are likely to be achieved by measures that focus on those with low incomes and whose incomes have sharply declined.

Temporary stimulus is necessary if stimulus is not to raise questions about the country's long run fiscal position. If stimulus were not credibly temporary, it would likely raise long term interest rates and increase capital costs offsetting its positive impact. Moreover if stimulus is not temporary, the risks that it will continue even after the economy recovers and lead to inflation or very high interest rates is greatly increased. Stimulus should be designed so that its proximate impact on consumer or government spending is all felt within a year of enactment and in any event by the end of the first quarter of 2009. If fiscal credibility is to be maintained, it is important also that no measures be enacted on a temporary basis that will generate overwhelming political pressures for their extension.

On the tax side, these considerations suggest the desirability of across-the-board equal tax cuts or refunds for all tax-filers, as the President and House agreed last week. Measures which reduce taxes in proportion to taxes currently paid or that disproportionately favor upper income taxpayers or recipients of capital income are likely to be far less effective because such taxpayers spend much less of new income than low and moderate income taxpayers. Measures which commit today to reduce future taxes relative to current law are likely to be counterproductive because of the fiscal doubts they raise and because they do not provide liquidity now, which is precisely the moment when consumers are facing the need to cut back spending.

From these perspectives, the proposal agreed by the House and Administration is a very valuable step forward. It is timely, targeted and temporary. I believe it could be improved however in two ways:

Business incentives: As I stated previously, the case for business rebates is not compelling. The experience with the 2001 stimulus program is not very encouraging with respect to the efficacy of business incentives as stimulus. Nonetheless, a properly-targeted temporary investment tax credit or accelerated depreciation scheme might pull some investment forward from future years into 2008. To maximize the bang for the buck, such a program should be incremental and apply only to investment above some benchmark, such as ⅔ of previous investment or depreciation.

Increases in benefits: The agreement between the House and the President failed to adopt increases in benefits, such as unemployment insurance and food stamps, in spite of significant nonpartisan research championing them as the most efficient stimulus options. A recent study by the Congressional Budget Office found that out of all stimulus options, only unemployment benefits and food stamps were cost-effective in terms of the demand they generate relative to their cost, featured a short lag between enactment and realization of the stimulus effect, and could be predicted to be effective with substantial certainty. Such increases can be implemented quickly, and the benefits go to people who will spend them fast. In addition, these benefits provide assistance to the innocent victims of recession, the people who struggle most to pay heating bills, to pay their monthly credit card bills, and to stay employed so that they can support their families.

6. SHOULD STIMULUS BE PAID FOR WITHIN A GIVEN BUDGET WINDOW?

Fiscal stimulus to an economy in recession operates by increasing demand in an economy that is constrained by lack of demand. If it is paid for contemporaneously, its point is largely lost as there is no net stimulus to demand because money injected in one area is withdrawn in another.

As long as a fiscal stimulus program is temporary and does not create expectations of future spending or tax cuts, it does not make a large economic difference whether or not it is offset by specific future fiscal actions. Including offsets in a five or a ten year window would magnify the impact of fiscal stimulus a little bit by reducing any adverse impact on capital costs because it would avoid any increases in long run debt levels. But it would also run the risk of delay in providing stimulus as the Congress debated possible offsets.

7. WHAT ARE THE MOST IMPORTANT BUDGETARY ISSUES GOING FORWARD AFTER THE STIMULUS DEBATE?

While stimulus is appropriate in the short run, the United States needs over the medum term to restors its fiscal health to the level of the 1990s. Deficit reduction is essential if capital costs are to be low enough to encourage healthy investment in the future of our economy. As part of the concern about deficit reduction, over time it will be necessary for Congress to look at among other things: (i) health care spending on a systematic national basis, (ii) Social Security and its actuarial soundness which has deteriorated in recent years; (iii) budget process issues (iv) tax evasion and avoidance among other things.

Chairman SPRATT. Dr. Rivlin.

STATEMENT OF ALICE M. RIVLIN, PH.D., SENIOR FELLOW, THE BROOKINGS INSTITUTION

Ms. RIVLIN. Thank you, Mr. Chairman.

I am very happy to be here this morning to urge the Congress to enact the stimulus package quickly. I am not quite as gloomy as Larry, but frankly we don't know what is going to happen to the economy. I think a well-designed stimulus package is needed now as an insurance policy to reduce the risk of recession or mitigate its severity if it occurs. The compromise worked out by the President and the Speaker is well designed to stimulate spending quickly because it focuses on low- and moderate-income people, and I think it should be enacted as quickly as possible.

I think the Congress should resist the temptation to delay the package by adding other elements, however worthy, and I would certainly think there are things that could have been added, but as you said earlier, nobody gets everything they want in a compromise.

The risks posed by the package that it will aggravate inflation or add to the long-run deficit are real, but I think they are worth taking to help stabilize the economy in the months ahead. The economy slowed sharply in the fourth quarter of 2007, after growing strongly in the third, and the current quarter is beginning with signs of weakness as well.

Unemployment rose in December, although 5 percent is still a pretty good number, and employment increase has stagnated. Retail sales have fallen off, and the housing sector continues to plunge. Although some indicators—notably exports—are positive, it is clear that the economy is in a period of slow growth and possibly headed for recession. Some economists are predicting a long or deep recession, including my colleague on the right. The gloomiest forecasts are coming from economists associated with major financial institutions, which is not surprising.

The truth is we simply do not know. The economists are notoriously bad at predicting turning points in the economy and frequently overpredict recessions or miss their beginnings. The slowing economy is no surprise. Indeed, many were expecting it sooner, for reasons that I will skip over at the moment, but the economy is now being pummeled from above and below.

In addition to the fallout from declining housing, rising foreclosure rates, we have seen massive losses to financial institutions on Wall Street and in other financial centers whose ultimate magnitude is still unclear, continuing uncertainty about the ultimate value of the assets backing many securities, and a sharp contraction in the willingness of financial institutions to lend, even to each other.

The risks that the slowdown could be prolonged or turned into a serious downturn has clearly risen considerably in recent weeks. The Federal Reserve has moved aggressively to lower interest rates and infuse liquidity into the banking system. However, monetary policy may act slowly, and putting total reliance on monetary policy to stimulate spending carries some risk.

Given recent experience with asset price bubbles, pushing interest rates towards zero, as the Federal Reserve did in response to the 2001 recession, seems like an invitation to another bubble, and widening the gap between interest rates in the U.S. and other currencies could cause a more rapid than desirable fall in the value of a dollar. Hence, it seems sensible to take out an insurance policy by adding a quick-acting fiscal stimulus to the monetary stimulus already underway.

The whole point of a stimulus package is to put money into the hands of people who will spend most of it when they get it, and the proposal, negotiated by the Speaker with the administration, is well designed to do that.

The idea is, quite simply, to send checks to working people with low or moderate incomes. Under the proposal, everyone who earned $3,000 or more in 2007 would get $300, if you're familiar with the provisions of the proposal. The amounts are big enough to make a significant difference in consumption, especially for low-income families with children.

The Center for Budget and Policy Priorities calculates that a couple with two children and earnings of $35,000 would get a rebate of $1,800. That is not insignificant. The plan phases out payments for those with incomes over $75,000, which allows the payments to be larger for a given total revenue loss, and more concentrated on low- and middle-income workers.

The package is considerably more progressive than the plan originally floated by the administration, and at the top, it is more progressive than the proposal being discussed by Senator Baucus. The investment incentives in the package would add modest inducements for businesses to spend more on plant and equipment in 2008.

The proposal also increases the loan limits for Fannie Mae, Freddie Mac and the Federal Housing Administration, which rising home prices in many areas have made obsolete. The formula would tie loan limits to median house prices in the metropolitan area. This new flexibility could help these entities operate more effectively to facilitate home financing and refinancing, especially in areas where prices rose most rapidly, and may avoid some foreclosures.

I believe the government should intensify its efforts to work with lenders and community groups to keep families who have been making their payments in their homes, where possible; but these additional efforts do not belong in a stimulus package. Quick passage, I think, is more important than improvements, although improvements are possible.

There are persuasive arguments for adding other elements to the proposed stimulus. Increasing food stamp benefits temporarily would get additional resources into the hands of very low-income people, including needy seniors, many of whom will be missed by the current proposal. Extending unemployment benefits by 13 or 26 weeks, which has been done in prior recessions, is especially appealing now, because long-term unemployment is disproportionately high.

A strong case can be made for assisting the States most easily by increasing the Federal contribution to Medicaid. Such aid would help forestall State tax increases or benefit cuts, actions that States often take to balance their budgets in a slowing economy, and that tend to make recessions worse.

Personally, I would favor all of these measures, especially if the economic indicators turn more negative, but I believe it would be a mistake to slow down enactment of the current proposal by adding controversial amendments to the package now. In particular, Congress should resist the temptation to add construction projects to the stimulus bill. Building and repairing infrastructure can contribute to long-run growth and productivity, but such projects spend out too slowly to provide economic stimulus in time to be an effective antidote to a recession.

Is the stimulus package without risks? Of course not. With core consumer price inflation running somewhat above 2 percent and the threat of rising energy prices passing through to other prices, stimulus could add to inflationary pressure, especially if the slowing economy, as we all hope, turns around quickly. The inflationary risk appears small, however.

In recent years, the economy has proved itself much less inflation-prone than it was when oil price surges led to stagflation in the 1970s. The American economy is more energy-efficient, more flexible and competitive, more exposed to downward pressure on prices and wages in the global economy, and less unionized than in previous decades.

As a result, inflation expectations, which can become self-fulfilling prophesies, remain low. Moreover, the Federal Reserve, my former colleagues, which cherishes its credibility as an effective inflation fighter, can be counted on to keep a close eye on present trends and to suspend monetary easing if it detects a serious inflationary threat. The bigger risk, as Larry has emphasized, is that the stimulus package, especially with major add-ons, will exacerbate the already ominous, long-run deficit picture.

Looking ahead, the United States faces mounting spending pressures as the baby-boom generation retires and the growth of medical spending continues to rise faster than the economy can grow. The Congressional Budget Office's long-run projections show clearly that if past trends continue, spending for Medicaid, Medicare and Social Security alone will swell to equal the proportion of total economic output currently devoted to the whole Federal Government. The cost of fulfilling promises made under the three major entitlement programs has put the whole Federal budget on an unsustainable track and will force hard choices that the political system is simply not recognizing at present. Indeed, our high and rising debt already constrains Federal policy, including efforts to move aggressively against a recession.

In this situation, is it irresponsible to enact a stimulus package that will add to the debt we are passing on to future taxpayers? I do not think so. I believe that the stimulus package should be paid for over a 5-year period. I was disappointed that you waived PAYGO for this. The PAYGO principle has never been more important, and it should be honored. Making exceptions can become a dangerous habit. Nevertheless, even if it is not subjected to the PAYGO rules, the proposed stimulus will not add significantly to the long-run deficit problem. The rebates are one-shot payments with much less deficit impact than a permanent reduction in tax rates.

Moreover, if the combination of monetary and fiscal policy is successful in stimulating the economy and attenuating the downturn, bigger increases in the deficit may be avoided. Hence, if Congress can resist the temptation to add spending increases or revenue losses to the stimulus package, I believe the deficit increase associated with the stimulus represents a risk worth taking in order to reduce the chances of recession or mitigate its impact.

Thank you.

Chairman SPRATT. Thank you very much.

[The prepared statement of Alice M. Rivlin follows:]

PREPARED STATEMENT OF ALICE M. RIVLIN, THE BROOKINGS INSTITUTION*

Mr. Chairman and Members of the Committee: I am happy to be here this morning to urge Congress to enact a stimulus package quickly. In brief, I believe that:

- A well-designed stimulus package is needed now as an insurance policy to reduce the risk of recession or mitigate its severity if it occurs;
- The compromise worked out by the President and Speaker Pelosi is well-designed to stimulate spending quickly, because it focuses on low- and moderate income people, and should be enacted as soon as possible;
- The Congress should resist the temptation to delay the package by adding other elements, however worthy, at this time;
- Risks posed by the package—that it will aggravate inflation or add to the long-run deficit—are worth taking to help stabilize the economy in the months ahead.

I will elaborate briefly on each of these points.

WHY AN INSURANCE POLICY IS NEEDED

The economy clearly slowed sharply in the fourth quarter of 2007 after growing strongly in the third, and the current quarter is beginning with signs of weakness as well. Unemployment rose in December—although 5 percent is still a pretty good number—and employment increases stagnated. Retail sales have fallen off, and the housing sector continues to plunge. Although some indicators, notably exports, are positive, it is clear that the economy is in a period of slow growth, possibly headed for a recession. Some economists are predicting a long or deep recession. The gloomiest forecasts are coming from economists associated with major financial institutions. The truth is: we simply do not know. Economists are notoriously bad at predicting turning points in the economy and frequently over-predict recessions or miss their beginnings.

The slowing of the economy is no surprise; indeed, many were expecting it sooner. The rapid increase in housing prices in many parts of the country, led to a big upswing in home building, some of it speculative. We simply built too many houses. When prices peaked and began to decline, housing construction fell off, construction workers were laid off, and the fall-out spread from the home construction, real estate, finance and insurance industries, to other sectors, especially in areas where house prices had risen most and home-building was frenetic. Consumers, who had been spending out of their rapidly-increasing home equity, found it leveling off or falling and began to retrench.

The housing boom was financed by the combination of low interest rates and a rapidly expanding market for mortgage-backed securities. Even without the explosion of sub-prime lending, the rapid upswing in housing construction and prices would have run its course and put some downward pressure on the economy. However, instead of a normal housing cycle we had a perfect storm—a lethal combination of historically low interest rates, widespread public conviction that housing prices could only go up, enthusiastic experimentation with sub-prime and other unfamiliar mortgage instruments, failure of the fragmented regulatory system to rein in irresponsible mortgage lending behavior, and failure of risk managers at financial institutions and rating agencies to anticipate the fall in value of mortgage-backed securities that would inevitably occur when housing prices peaked and foreclosure rates rose.

The economy is now being pummeled from above and below. In addition to the fallout from declining housing and rising foreclosure rates, we have seen massive losses to financial institutions on Wall Street and in other financial centers, whose

*The views expressed in this testimony are those of the author and should not be attributed to the staff, officers or trustees of the Brookings Institution.

ultimate magnitude is still unclear, continuing uncertainty about the ultimate value of the assets backing many securities, and a sharp contraction in the willingness of financial institutions to lend—even to each other. The risk that the slowdown could be prolonged or turn into a serious downturn has clearly risen considerably in recent weeks.

The Federal Reserve has moved aggressively to lower interest rates and infuse liquidity into the banking system. However, monetary policy may act slowly, and putting total reliance on monetary policy to stimulate spending carries some risk. Given recent experience with asset price bubbles, pushing interest rates toward zero, as the Federal Reserve did in response to the 2001 recession, seems like an invitation to another bubble, and widening the gap between interest rates in the U.S. and other currencies could cause a more rapid than desirable fall in the value of the dollar. Hence, it seems sensible to take out an insurance policy by adding a quick-acting fiscal stimulus to the monetary stimulus already underway.

STRENGTHS OF THE PROPOSED PACKAGE

The whole point of a stimulus package is to put money into the hands of people who will spend most of it when they get it, and the proposal negotiated by the Speaker with the Administration is well designed to do that. The idea is quite simply to send checks to working people with low or moderate incomes. Under the proposal everyone who earned $3000 or more in 2007 would get $300 ($600 per couple plus $300 per child), even if they did not earn enough to pay income tax. Those who did pay income tax would get up to $300 ($600 per couple) more. The amounts are big enough to make a significant difference in consumption, especially for low income families with children. The Center for Budget and Policy Priorities calculates that a couple with two children and earnings of $35,000 would get a rebate of $1800. The plan phases out payments for those with incomes over $75,000 ($150,000 per couple), which allows the payments to be larger (for a given total revenue loss) and more concentrated on low- and middle-income workers. The package is considerably more progressive than the plan originally floated by the Administration.

The investment incentives in the package would add modest inducements for businesses to spend more on plant and equipment in 2008. The proposal also increases the loan limits for Fannie Mae, Freddie Mac, and the Federal Housing Administration (FHA), which rising home prices in many areas had made obsolete. The formula would tie the loan limits to median house prices in the metropolitan area. This new flexibility should help these entities operate more effectively to facilitate home financing and refinancing, especially in areas where prices rose most rapidly, and may avoid some foreclosures. (I believe the government should intensify its efforts to work with lenders and community groups to keep families who have been making their payments in their homes where possible. But these additional efforts do not belong in a stimulus package.)

QUICK PASSAGE IS MORE IMPORTANT THAN IMPROVEMENT

There are persuasive arguments for adding other elements to the proposed stimulus. Increasing Food Stamp benefits temporarily would get additional resources into the hands of very low income people, including needy seniors, many of whom will be missed by the current proposal. Extending unemployment benefits by 13 or 26 weeks, which has been done in prior recessions, is especially appealing now, because long-term unemployment is disproportionately high. A strong case can be made for assisting the states, most easily by increasing the federal contribution to Medicaid. Such aid would help forestall state tax increases or benefit cuts—actions that states often take to balance their budgets in a slowing economy and that tend to make recessions worse. Personally, I would favor all these measures, especially if the economic indicators turn more negative, but I believe it would be a mistake to slow down enactment of the current proposal by adding controversial amendments to the package now.

In particular, Congress should resist the temptation to add construction projects to the stimulus bill. Building and repairing infrastructure can contribute to long-run growth and productivity, but such projects spend out too slowly to provide economic stimulus in time to be an effective antidote to recession.

WHY THE RISKS ARE WORTH TAKING

Is a stimulus package without risk? Of course not! With core consumer price inflation running somewhat above 2 percent and the threat that rising energy prices will cause other price increases to accelerate, stimulus could add to inflationary pressure, especially if the slowing economy turns around quickly. The inflationary risk appears small, however. In recent years, the economy has proved itself much less inflation prone than it was when oil price surges led to stagflation in the 1970's. The American economy is more energy-efficient, more flexible and competitive, more exposed to downward pressures on prices and wages in the global economy, and less unionized than in previous decades. As a result inflation expectations, which can become self-fulfilling prophesies, remain low. Moreover, the Federal Reserve, which cherishes its credibility as an effective inflation fighter, can be counted on to keep a close eye on price trends and to suspend monetary easing if it detects a serious inflationary threat.

The bigger risk is that the stimulus package, especially with major add-ons, will exacerbate the already ominous long-run deficit picture. Looking ahead, the United States faces mounting spending pressures as the baby boom generation retires and the growth of medical spending continues to rise faster than the economy can grow. The Congressional Budget Office's long run budget projections show clearly that, if past trends continue, spending for Medicare, Medicaid and Social Security alone will swell to equal the proportion of total economic output currently devoted to the whole federal government. The cost of fulfilling promises made under the three major entitlement programs has put the whole federal budget on an unsustainable track and will force hard choices that the political system is simply not recognizing at present. Indeed, our high and rising debt already constrains federal policy, including efforts to move aggressively against recession. In this situation is it irresponsible to enact a stimulus package that will add to the debt that we are passing on to future taxpayers?

I believe that the stimulus package should be paid for over a five-year period. The PAYGO principle has never been more important and should be honored. Making exceptions can become a dangerous habit. Nevertheless, even if it is not subjected to the PAYGO rules, the proposed stimulus will not add significantly to the long-run deficit problem. The rebates are one-shot payments with much less deficit impact than a permanent reduction in tax rates. Moreover, if the combination of monetary and fiscal policy is successful in stimulating the economy and attenuating a downturn, bigger increases in the deficit may be avoided. Hence, if Congress can resist the temptation to add permanent spending increases or revenue losses to the stimulus package, I believe the deficit increase associated with the stimulus represents a risk worth taking in order to reduce the chances of recession or mitigate its impact.

Thank you for listening. I would be happy to answer questions.

Chairman SPRATT. Mr. Greenstein.

STATEMENT OF ROBERT GREENSTEIN, EXECUTIVE DIRECTOR, CENTER ON BUDGET AND POLICY PRIORITIES

Mr. GREENSTEIN. Thank you, Mr. Chairman.

As you know, in the past, stimulus packages often came too late, contained measures that were not timely targeted, temporary, or both. You are certainly off to a good start. At this point, you will be voting, I believe today, on a package that I certainly hope you will pass. The Senate Finance Committee will be marking up tomorrow, and the Chairman's mark, announced yesterday, contains some provisions that I think would further strengthen the stimulative effects of the package. It may be on the Senate floor by Thursday, and I hope you will be able to pass it and send it to the President before the President's Day recess.

In a hearing in the last week or so at the Senate Finance Committee, Martin Feldstein noted that in the current context, in an economy where there is extra slack, we really do want to increase consumer spending. I would like to talk for a couple of minutes about how most effectively to do that.

As the Congressional Budget Office and other economists such as Larry Summers have noted, stimulus measures are more effective when they are focused on lower-income households than higher-income households because people who live paycheck to paycheck tend to spend rather than save nearly all of the added income. Analyses of the 2001 tax rebates found that lower-income households spent a larger share of the rebates than more affluent households did.

This strongly suggests that the bipartisan House leaders made a wise decision last week when they included most low-income working families in the tax rebates. It also points to a way in which the stimulus package could be strengthened, hopefully, in the Senate.

Under the House package, working poor families will receive considerably smaller rebates than more well-off families. A mother with one child, who works full time at the minimum wage and makes about $12,000 a year, will get a rebate of $600, while a family of the same size, say a married couple making $150,000 a year, will get a rebate of $1,200, or twice as much. The rebates would be more effective as stimulus if the rebate amounts were uniform, a point, I think, Larry Summers has been making for the past month in various forums.

Senator Baucus' mark, announced yesterday, would remedy that by making the rebates uniform, so the working poor families would get the same size as middle- or upper middle-income families, and it also includes an element under the current House package. Middle-income elderly would get rebates, but lower-income elderly would not, and under his mark, lower-income elderly and middle-income elderly are both in.

Now, one limitation of the rebates is that they will take some time to work. The first rebate checks apparently can't go out until late May, and many families won't receive their rebates until July, or possibly early August. The whole point of moving so quickly is to start injecting demand into the economy as quickly as you can. And I, therefore, think it would be very useful—and I am echoing Larry's analysis here—very useful to include in the package—again, this could be done in the Senate—two provisions that most experts agree would be highly effective as stimulus and are the two most fast-acting options on the table. These, of course, are the provisions related to unemployment insurance and food stamps.

In CBO's recent report on stimulus options, the unemployment insurance and food stamp options are the only items that receive CBO's top rating in all three of CBO's categories for evaluating stimulus options. CBO said these two options would, one, have large effects on a bang-for-the-buck basis; two, only a short time lag between enactment and the time by which the policy has achieved the bulk of its stimulative effect; and, three, carry only a small degree of uncertainty as to the stimulative effects. Now, if you look at the CBO report, you find that no other tax or spending options CBO evaluated gets CBO's top rating for even two of these categories, let alone all three.

In an analysis on Friday, Goldman Sachs made essentially the same point. And MoodysEconomy.com published an analysis last week, looking at the various options, and it found the following: It estimated that a temporary increase in food stamp benefits would generate $1.73 in increased economic activity for each dollar in cost; unemployment insurance, $1.64 per dollar in cost; the tax rebates, $1.26 for each dollar in cost; and the bonus depreciation tax cut, which is in the package, 27 cents in increased economic activity per dollar of cost.

The reason the UI and food stamp provisions rate so highly as stimulus is clear. They target people who either have very low incomes and spend every dollar they get, or are facing large declines in income because they've lost their jobs, and their unemployment benefits are running out, and if they don't get a continuation, there will be a big drop in consumption. They also are the two items that can be implemented most rapidly.

For example, to take food stamps, a topic I know particularly well, an increase in food stamp benefits can be implemented in 30 to 60 days after enactment, as early as April 1st in some States, and studies show that 97 percent of the benefits are spent by the end of the month. I think that is why such people as from Martin Feldstein, to Larry in his written testimony today, Alice as you've just heard, all rate food stamps as one of the most effective things you can do.

Now, as you know, the Chairman's mark in the Senate does include an unemployment insurance provision. Food stamps may be considered on the Senate floor.

One final issue, although I think this final issue is probably not for the current package—none of you would think of raising taxes now or paying for a stimulus package with simultaneous tax increases or spending cuts that would take effect right now. That would be a drag on the economy. Bad idea. Yet we are headed for large budget cuts and tax increases at State and local levels across the country, and those actions will be a drag on the economy. They will offset a portion of the effect of the Federal stimulus package.

As you know, States are required to balance their budgets, even in recessions, so they raise taxes and cut spending in recession. The majority of States are now reporting budget deficits for fiscal year 09, which starts July 1 in most States, and those numbers are rising as more Governors bring out their budgets each week. It does look like large State budget cuts and tax increases are in store. Two States have already enacted large tax increases to close projected deficits. Governors and legislative leaders in a growing number of States are proposing hefty cuts in areas ranging from reducing health coverage of low-income children to education and other basic services. In the last downturn, for example, State Medicaid cuts led to the loss of health care coverage for about a million low-income people, and aggravating the problem right now are falling property tax revenues as a result of declining home values.

In my view, this suggests that if not now—which doesn't look like it is going to happen—then in the not-too-distant future, Congress really ought to pay attention to this and provide some fiscal relief to lessen the degree to which States take contractionary actions that slow the economy.

I would note—this is with a little disappointment—that the current stimulus package does make this problem somewhat worse in that the bonus depreciation tax cut in the package will cause 30 States to lose $4 billion in revenue because of linkages between Federal and State tax codes. The States will have to raise taxes or cut budgets somewhat more.

Now, in conclusion, the current work on the stimulus package is off to a very promising start. It is my hope you will pass the package today. It is my hope that it can be strengthened in the Senate without causing any delay. I agree on the need for fast action, and hopefully within 10 days or so, a good package can be on its way to the President.

Thank you.

Chairman SPRATT. Thank you, Bob Greenstein.

[The prepared statement of Robert Greenstein follows:]

PREPARED STATEMENT OF ROBERT GREENSTEIN, EXECUTIVE DIRECTOR, CENTER ON BUDGET AND POLICY PRIORITIES

I appreciate the invitation to testify before the Committee. I am Robert Greenstein, director of the Center on Budget and Policy Priorities, a policy institute that specializes in fiscal policy as well as in policies related to low- and moderate-income families. The Center does not, and never has, received any federal grants or contracts.

I would like to start with some observations about the importance of taking business cycles into account when evaluating fiscal policy options. The economy always grows—and revenue always increases—during economic recoveries and periods of normal economic growth. Sometimes this may lead to mistaken assumptions that certain policies whose adoption coincided with the start of a recovery caused the recovery or the resulting revenue growth. Thus, a claim is often made that the tax cuts enacted at the start of this decade caused the recovery and the revenue growth of recent years, or at least made the growth much greater than it otherwise would have been. The same logic, however, could be used to argue that the tax increases enacted in 1990 and 1993 caused the boom of the 1990s. Neither claim is especially credible.[1] I also would note that during the recovery of recent years, which now appears to be ending, both economic and revenue growth were actually slower than during the recovery of the 1990s, and also slower than the average for comparable business-cycle periods since the end of World War II. That further weakens the case that the tax cuts of 2001 and 2003 spurred strong growth.

Issues related to economic cycles are important again at the present time, as we think about appropriate measures to stimulate the economy and keep it out of recession (or to prevent a recession from becoming more severe). This is because the types of policy measures that are needed to stimulate the economy in the short term are very different from the policies one would want to pursue to improve prospects for long-term growth.

For the long term, we need more saving and less consumption, policies to avert the persistent, large deficits that loom in future decades, and appropriate investments in things that can boost productivity such as education, basic research, and infrastructure. In contrast, what we need now is to keep consumption as strong as possible, rather than to increase saving. And various investments and other policies that may be useful for long term growth will not constitute effective stimulus in the short term, unless they inject increased demand into the economy quickly.

Similarly, while ongoing tax cuts and entitlement increases should be fully paid for, it would not make sense to offset temporary stimulus measures by cutting programs or raising taxes in the same year, since doing so would diminish the stimulus effects.

WHAT SHOULD WE DO NOW?

So what should we do now to stimulate the economy? As Martin Feldstein told the Senate Finance Committee last week, "In the current context, in an economy where there's extra slack * * * we really do want to increase consumer spending."

The primary consumers are U.S. households. They are not the only consumers, however. Businesses and governments buy goods and services as well. We should pay attention to all three.

HOUSEHOLD SPENDING

As the Congressional Budget Office and other economists have noted, stimulus measures that put more income into people's pockets are more effective when focused on low-income households, and less effective when focused on high-income households. This is because people who live paycheck to paycheck tend to spend,

[1] As Robert Hall of the Hoover Institution has noted, "The U.S. economy recovered from every single recession it ever had, so the growth in 2003-2006 was generally part of the normal cyclical recovery." See Daniel Altman, "Did the Tax Cuts Bolster Growth?," New York Times, May 13, 2007.

rather than save, nearly all of their added income, while those at high income levels would tend to bank much of it. Analyses of the 2001 tax rebates show that lower-income households spent a larger share of their rebates than affluent households did.

This suggests that House leaders made the right decision last week when they included most low-income working families in the tax rebates that they designed. Excluding such families would have made the rebate significantly less effective as economic stimulus. A recent analysis by Moody's Economy.com estimates that a rebate that fully includes such families would be 24 percent more effective as stimulus than a rebate that excludes these families (generating $1.26 in increased economic activity per dollar of cost, as compared to $1.02 for a rebate that leaves these families out).

This also points, however, to a shortcoming in the rebate design. Under the agreement announced last week, working-poor families would receive considerably smaller rebates than more well-off families. Thus, a mother with one child who works full time at the minimum wage and makes less than $12,000 would receive a rebate of $600, while a married couple making $150,000 would receive a rebate of $1,200—or twice as much. The rebates would be more effective as stimulus if the rebate amounts were uniform, with the rebates that working-poor families receive being the same size, rather than smaller, than the rebates going to families at higher income levels.

TWO MISSING COMPONENTS

One limitation of the rebates is that they will take some time to work. The first rebate checks apparently can not go out until late May, and many families will not receive their rebates until July or possibly early August. Yet the reason that House leaders and the Administration sought to move so expeditiously was to inject increased demand into the economy quickly.

Therefore, I believe it was a mistake to drop the only two provisions that most experts agree would be both highly effective as stimulus and fast-acting—the provisions related to unemployment insurance and food stamps. In CBO's recent report on stimulus options, the unemployment insurance and food stamp options are the only items that receive CBO's top rating in all three of CBO's categories for evaluating the various options. CBO found that these two options would:

- have "large" effects in generating increased economic activity per dollar of cost;
- entail only a "short" lag between enactment and the time by which the policy has achieved the bulk of its stimulative effect; and
- carry only a "small" degree of uncertainty as to the policy's stimulus effects.

No other tax or spending option received CBO's top rating in even two of the three categories, let alone all three.

A number of private financial analysts have reached similar conclusions. In an analysis issued Friday, Goldman Sachs essentially made these same points and counseled that temporary increases in UI and food stamps have "strong policy justifications" as stimulus.[2]

Similarly, an analysis issued last week by Moody's Economy.com, which examined the effectiveness of various stimulus options, gave its highest rating for effectiveness to the food stamp and UI options. The analysis found that:

- A temporary increase in food stamp benefits would generate $1.73 in increased economic activity for each $1 in cost.
- Extending unemployment benefits so workers' benefits do not run out before they find a new job would be the second most effective measure, generating $1.64 in increased activity per dollar of cost.
- By comparison, tax rebates that fully include low- and moderate-income working families would generate $1.26 in increased economic activity per dollar of cost.
- And the principal business tax cut in the new stimulus package—a proposal to accelerate the depreciation write-offs that firms take—would generate 27 cents in increased economic activity per dollar of cost.

There are two reasons why the UI and food stamp provisions rate so highly as stimulus. First, these provisions would help people who either have very low incomes and are extremely cash constrained, or who otherwise face a precipitous decline in income because they have lost their jobs and now face the expiration of their unemployment benefits (and may cut their consumption sharply as a consequence). Because the food stamp and UI provisions are targeted on these groups, most of the resources that these provisions would provide to families would be spent quickly.

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[2] Goldman Sachs, "Refilling the Punch Bowl: The Prospects for Fiscal Stimulus," Jan. 25, 2008.

The second reason these provisions rate highly is that they can be implemented rapidly.

Take food stamps as an example. Food stamp households are poor—90 percent of them live in poverty—and research has found that about 80 percent of food stamp benefits are spent within two weeks of a household's receiving them. Some 97 percent of the benefits are spent by the end of the month. Furthermore, an increase in food stamp benefits can be implemented in 30-60 days after enactment, depending on the state.

There also is a point about unemployment benefits worth noting. The long-term unemployment rate—the percentage of people in the workforce who have been unemployed for at least 26 weeks and are still looking for work—was nearly twice as high in the last quarter of 2007 as it was immediately before the 2001 recession. This is significant both because it is the long-term unemployed who reduce their consumption the most and because stimulus measures that provide additional weeks of unemployment benefits are targeted on this group.

BUSINESSES

Businesses make purchases, as well. They also hire or fire workers. The effect on the business sector is crucial.

There often is misunderstanding, however, about which federal policies are most effective in maintaining business purchases and employment when the economy weakens materially. The primary factor in such circumstances is not the cash that businesses have on hand; it is whether customers are spending money and buying their products.

A business with ample cash to spend (whether through profits, savings, or government tax incentives) will not spend more, or refrain from laying off workers, if there is not sufficient demand for its products. Demand is a far more important factor than cash on hand in the employment and investment decisions of firms that see their responsibility as making profits for their shareholders. A firm that retains workers whom it does not need to produce the goods and services it can sell is essentially wasting its money and failing to fulfill its responsibility to its shareholders.

As Goldman Sachs explained in an analysis last fall, "companies don't spend money just because it's there to spend. To justify outlays for new projects, the expected returns have to exceed the costs, and that usually requires growth in demand strong enough to put pressure on existing resources." [3]

As a result, the single most effective way to maintain business spending and hiring is to maintain consumer demand. The tax rebate, unemployment insurance, and food stamp measures discussed above would all serve this goal.

In contrast, business tax incentives tend to be less effective as stimulus, as CBO and other analysts have pointed out. A temporary investment incentive targeted to new investment (as distinguished from investments that have already been made) may provide some stimulus in situations where weakness in the economy is causing firms to postpone positive planned investments—if the incentive succeeds in inducing firms to accelerate their investment plans. But the stimulative effects of such incentives are likely to be considerably more modest than the effects of measures that put the same amount of money in the pockets of households that will spend it, because a substantial share of the investment spending subsidized through the tax incentives—even if limited to new investments—will be investment that would have been made anyway.

This is borne out by the leading study that examines the effects of the "bonus depreciation" tax incentives that were enacted in 2002 and 2003 to provide stimulus during the last recession. The study, by Federal Reserve economists, found that bonus depreciation had, at best, "only a very limited impact" on investment spending. Similarly, as noted earlier, Moody's Economy.com estimates that bonus depreciation, the principal business tax cut in the new stimulus package, would generate only 27 cents in increased economic activity per dollar of cost.

GOVERNMENTS

The actions of governments, as well, affect aggregate demand in the economy. Government actions that raise taxes or cut payments to beneficiaries or to firms or agencies that provide services reduce aggregate demand. When such actions are taken during an economic downturn, they make the downturn deeper.

No federal policymaker would think of raising taxes now or paying for a stimulus package with contemporaneous tax increases or spending cuts. Yet we are headed for large budget cuts and tax increases at state and local levels. Those actions will

[3] GS Weekly, September 21, 2007.

be a drag on the economy. They will offset the positive effects of a significant portion of the federal stimulus package.

Unlike the federal government, state governments (except Vermont) are required by their own laws or constitutions to balance their budgets every year, even during recessions. As a result, states cut programs and raise taxes in recessions. This decreases the amount of money that people have to spend or that the state spends, and thereby makes the downturn deeper.

As of last week, 25 states were reporting budget deficits for fiscal year 2009, which starts July 1 in most states. This number is rising almost daily, as governors release their budgets and issue new budget estimates. We expect that within a few weeks, as more states issue new budget forecasts, at least 30 states will be facing deficits.

Of the 25 states that have released new budget estimates and are projecting deficits, only 18 have issued specific deficit estimates to date. In these 18 states alone, the projected deficits total nearly $32 billion. This figure will rise much higher as budget data become available for all states.

This means that large state budget cuts and tax increases are in store. Two states have already enacted substantial tax increases to help close projected deficits. Governors and legislative leaders in a growing number of states are proposing hefty budget cuts, ranging from eliminating health care coverage for thousands of low-income children and elderly individuals to slashing funding for education, child care, and other basic services. When recession hits, health care, education, and aid to local governments are typically the three principal parts of state budgets that absorb the bulk of the cuts. In the last downturn, for example, state Medicaid cuts led to the loss of health care coverage for up to 1 million low-income people.

Moreover, an unusual circumstance is making the current fiscal situation even more troublesome for many states. Many local governments are facing falling property tax revenues because of declining home values and are turning to their state governments for help, so that they do not have to institute overly severe cutbacks in basic services like schools, police, and firefighting. This is intensifying the pressure on state budgets.

This strongly suggests that the federal government should provide some fiscal relief to states, whether in the current stimulus package or through another vehicle, as it did in the last recession. Lessening the degree to which states institute contractionary budget cuts and tax increases should be an important part of the federal response to the deterioration in the economy.

Unfortunately, the current stimulus package would actually make this problem worse. The bonus depreciation tax provision it contains will cause some 30 states to lose $4 billion in tax revenue, due to linkages between federal and state tax codes that the majority of states have adopted to promote simplicity. This will compel states to institute bigger increases in other state taxes or steeper budget cuts, which is a harmful outcome from a stimulus standpoint.

Two arguments are sometimes heard against fiscal relief. One is that some states are not in economic or fiscal difficulty. CBO has observed that fiscal relief which lessens the severity of state budget cuts or tax increases is stimulative, but fiscal relief provided to states not facing deficits is not.

This concern can be addressed by targeting relief on states facing economic and fiscal difficulty. That can be done by using such measures as data on state-by-state changes in employment, food stamp caseload, and foreclosures. These data can be used to develop mechanisms that target relief on states whose economies (and budgets) are in trouble.

A second question is whether, if the federal government provides aid to states in a recession, this creates a "moral hazard," in which states then respond during periods of solid economic growth by overspending, cutting taxes too much, or failing to build up "rainy day" funds and thereby exacerbating the fiscal problems they face in the next downturn because they are counting on the federal government to bail them out. The evidence strongly indicates that modest amounts of federal fiscal relief during recessions do not have this effect.

The federal government provided $20 billion fiscal relief in the last downturn. The data show that states have not overspent or slashed taxes since then in the expectation they would be bailed out during future downturns. On average, state expenditures as a share of the economy are lower now than they were in state fiscal year 2001, while state taxes as a share of the economy are at about the same level. In addition, once the recession ended, states built up substantial "rainy day" reserve funds to draw upon in the next downturn; at the end of 2006, those reserves were actually a little larger, as a share of annual state expenditures, than before the recession at the start of this decade. In short, the provision of fiscal relief in the last downturn was not followed by irresponsible actions on the states' part.

Although states built up substantial revenues (or rainy-day funds) before both the last recession and the impending one, recessions have such large effects on state budgets that they wipe out reserves and produce sizeable shortfalls. States began this decade with reserves equaling 10.4 percent of annual expenditures, a very substantial amount. Yet those reserves closed only about one-quarter of the state budget gaps that opened up through state fiscal year 2003.

Moreover, a recession now could have especially large effects on state and local revenues because of the effects of declining home values in causing property tax revenues to erode. In contrast, home values and property tax revenues held up during the last recession.

To be sure, it is quite possible that federal fiscal relief could create a "moral hazard" problem if it filled most or all of the state budget gaps that emerged during a recession. Relief of that magnitude, however, is not what anyone is talking about. The $20 billion in federal fiscal relief provided in 2003 closed only about 10 percent of the state budget shortfalls that emerged when the economy was weak in the early years of this decade. Today, the governors, on a bipartisan basis, are seeking a quite modest level of relief—$12 billion.

MOVING BEYOND IDEOLOGY AND FOCUSING ON STIMULATING THE ECONOMY

The task now is to focus laser-like on what would, and would not, be effective stimulus. Consideration of what will be good for the economy over the long term remains important. But that is a separate discussion—and should involve a separate set of decisions—from what is needed to provide effective stimulus now.

This means that certain nostrums need to be set to the side. For example, some people assume that tax cuts are inherently more stimulative than spending measures, but that assumption does not bear up well under scrutiny. As an array of distinguished economists (whose ranks include Nobel laureate Joseph Stiglitz, now-CBO director Peter Orszag, and Federal Reserve economists) have noted in the past, some spending measures and tax cuts can provide effective short-term stimulus, while other spending measures and tax cuts are ineffective as stimulus. Each measure needs to be evaluated on its own merits as stimulus. Simply labeling an option as "spending" or "tax" tells little.

The current process of developing a stimulus package is off to a promising start. It is my hope that in short order, an effective package will be enacted that both builds—and improves—upon the bipartisan package unveiled last week.

Chairman SPRATT. Now, Brian Wesbury, who has a slightly different slant on the current economic situation and on the package.

You are there on the panel to provide this diversity. We appreciate your coming. We are looking forward to your comments.

STATEMENT OF BRIAN WESBURY, CHIEF ECONOMIST, FIRST TRUST ADVISORS, L.P.

Mr. WESBURY. Thank you, Mr. Chairman, and thank you for offering to put my testimony in the record in full. I will summarize it here today.

You know, I am from the Midwest, the Chicago area. I work in the private sector, and so I am outnumbered here in many ways on this panel, and I am also outnumbered in my view on the economy.

I think the economy is in much better shape than most people believe. You know, if you go back about 6 months when this problem began, many people feared that GDP, for example, in the third quarter would grow at 2 percent or less. The actual number came in at 4.9 percent, a literal boom in the third quarter. They said that, well, that is backward-looking now, so we are going to look at the fourth quarter. We will probably get zero-percent growth in the fourth quarter. We actually ended up—we don't have the data yet, we will get it tomorrow—but our estimate with all the data we have so far is 1½ percent growth. So far, also, if you look at data that leaps us into the first quarter, we are projecting 3 percent growth in the first quarter for GDP as well.

Last week, initial unemployment claims came out. They had been rising in late November and early December, but now they have plummeted back to 301,000. This is an extremely low level. Never in the past have we had a recession with initial unemployment claims at this level. And today, durable goods orders for December were released, up 5.2 percent in the month of December. If you exclude transportation, they were up 2.6 percent. The fourth quarter's business investment numbers now show a 5.9 percent increase in business investment versus 6.1 in the third quarter. No change.

Now, I know I have thrown a lot of data at you, but I have never seen the level of pessimism that currently exists on the economy with virtually no evidence from the macroeconomic data to back it up. And therefore I think there is a large overreaction taking place today, that is potentially dangerous in the long run, to perceive the problems in the economy.

One last point on this. The housing market, which does have a great deal of problems today, is only 4½ percent of GDP. The export sector of the U.S. economy is 12 percent of GDP. Housing is clearly declining, but exports are booming today, up 14 percent from a year ago. And to strengthen that larger sector of the economy, the export sector, is actually overwhelming weakness in the housing sector, and that is why GDP continues to grow and initial unemployment claims remain very low.

Now, having said that, I obviously don't forecast a recession, but clearly there is always a risk. Mrs. Rivlin said today that, clearly, economists have missed many recessions in the past, and I am going to tell you I am not a perfect forecaster. So let's take a look at what we have done so far. And I believe the biggest action, clearly, has been that the Federal Reserve has reduced interest rates 175 basis points. At 3½ percent, the Federal funds' rate today is actually below the rate of inflation. In other words, we have a negative real interest rate. Never in the past have we had a recession when the Federal Reserve's—the Federal funds' rate is below the rate of inflation.

So what I would suggest to you is that the Federal Reserve has already done enough to offset a recession, even if it were to occur. It takes about 6 or 9 months for Federal Reserve rate cuts to affect the economy. That means they started in September, we should see those impacts in March, April, May, and June before rebate checks can even get out. So my belief is that the economy will actually be accelerating before any stimulus package can actually go into effect.

In addition, those rate cuts have caused some problems. We have inflationary pressures building in the economy. Last year, the consumer price index rose at its fastest rate in 17 years. The producer price index was up at its fastest rate since the early 1980s. The value of the dollar has plummeted. It is at its lowest rate in many, many years, and so more Federal Reserve rate cuts, which we also may get tomorrow, can actually put inflation into the system in a way we haven't seen in many decades.

Let me just make three quick comments about the stimulus package from my point of view. It is kind of interesting to me that, yesterday—and I mean this euphemistically—we were worried about excess consumer spending, a lack of savings, too much borrowing, and a Federal budget deficit; and today, we seem to be running headlong into trying to get consumers to spend more, to borrow more, and to run the Federal budget deficit up. That is a very interesting thing to me, and I think that is confusing to many Americans.

Number two, the impact of a stimulus is—it may help consumer spending for a month or two, but no manufacturer that I know of, no retailer that I know of, will build a new store or build a new manufacturing plant in order to accommodate some month-or-two stimulus in consumer spending.

There will be no long-term impact on job creation from a rebate program. In addition, because we already have a budget deficit, if the Federal Government borrows money to write rebate checks, we will be crowding out private investment at the very time our financial institutions need that investment. And therefore I think a stimulus package could actually backfire by draining capital and investment capital from the system when we really need it.

Finally, a stimulus package today that boosts the deficit, in my opinion, will make the permanence of the 2003 tax cuts less likely, and I think that is a negative thing for the markets in the long run. Our estimates show that the repeal of the 2003 tax cut, to go back to the pre-2003 tax rates, will boost the cost of capital for American corporations by 1 percent, which will reduce the value of U.S. equities by 20 percent. If you're worried about the stock market declining today, wait until you actually allow the cost of capital to rise by 1 percent for corporations. That is going to cause more problems.

So I would suggest that rather than doing temporary things, that we do long-term things. I would suggest that we make permanent the 2003 tax cut. I think U.S. corporations today face an uphill battle when you compare their tax rates to the rest of the world. I would suggest we cut the corporate tax rate in the United States to allow it to be equal to tax rates, for example, in continental Europe, which are in the mid-20s, instead of 35 to 40 percent like we have here. I would also index the capital gains tax to inflation. I think, as inflation begins to rise, that will magnify capital gains tax rates, which will hurt investment at the very time we really need it.

So, to summarize, my belief is that the economy is in much better shape than most people believe. I think the evidence shows that that is true today. There is no economic data on a broad base that shows the economy is falling apart, and I think an overreaction, not only by running up the deficit and forcing inflation higher, could actually cause more problems down the road than we have today.

Thank you very much.

[The prepared statement of Brian Wesbury follows:]

PREPARED STATEMENT OF BRIAN S. WESBURY, CHIEF ECONOMIST, FIRST TRUST PORTFOLIOS LP

I would like to thank Chairman Spratt and the Ranking Member Ryan for the opportunity to come before this committee to discuss the economy and the extremely important subject of economic stimulus. I would also like to remind the committee that as I speak today, I am speaking for myself and not for my employer, First Trust Portfolios LP.

I respectfully ask that my written testimony be included in the record in its entirety.

As we all know, the economy and financial markets have been buffeted by turbulence in recent months. As far back as August 2007, credit markets began to price in significant financial market problems. Since then, defaults and delinquencies on mortgages (especially sub-prime mortgages) have risen rapidly, home prices have fallen, the unemployment rate has moved higher, major U.S. financial institutions have taken large write-downs, and many of these companies have been forced to raise significant sums of capital, some of it from overseas.

Obviously, we are here today to discuss what Congress and the Administration can or should do about all of this.

But, in order to understand today's policy discussion, and its implications, I think it is important to put the current environment in the context of history. A series of five questions should put current economic issues and their policy implications in context.

1) How did we get here?
2) How bad is it?
3) Are Fed rates cuts enough?
4) Is more stimulus necessary?
5) Is there anything else that would help?

HOW DID WE GET HERE?

Twenty-five years ago, in the late 1970s and early 1980s, most intellectuals and many politicians were convinced that America's dominance in world economic matters had come to an end. The sun had set on the American Dream.

Between 1969 and 1982, America was in recession roughly ⅓ of the time—one out of every three years. At their peaks, both the unemployment rate and the inflation rate were above 10%, while the misery index—the combination of unemployment and inflation—rose to 21.9% in May 1980. Oil and gasoline prices, adjusted for inflation were little different than they are today, even though consumers had much less purchasing power. In 1981, the 30-year mortgage rate rose to a peak of 18.5%, while the prime rate hit 20.5%. President Carter called it a "malaise."

But in a surprise to the pessimists of twenty-five years ago, the US economy has boomed. Since 1982, the US economy has been in recession only 5% of the time. Over the past 20 years, inflation as measured by the consumer price index has averaged 3.1%, while the unemployment rate averaged 5.4%. The prime rate and 30-year mortgage rate have averaged 6% in the past five years, while the federal funds rate has averaged 3%.

This long boom, with its non-inflationary, low interest rate, recession-free environment, encouraged an increased appetite for leverage and risk by consumers and creditors. While much of this risk was prudent, and was based on a correct belief that incomes would continue to rise, at its fringes, credit standards and personal responsibility frayed to levels that could not be sustained.

This process accelerated between 2002 and 2004 when the Federal Reserve, in a battle against deflationary forces, drove interest rates down to levels not seen in almost 50 years. With the federal funds rate at 1%, the prime rate at 4%, and mortgage rates below 5%, exuberance gripped the housing market. Sub-prime loans, amounting to roughly $1 trillion dollars were issued. This is "ground zero" for the current financial problems facing the US today.

HOW BAD IS IT?

Despite significant dysfunction in the mortgage market, it is hard to imagine that there is any time in history when such rampant pessimism about the economy has existed with so little actual evidence to back it up.

Some data has been weak. For example, retail sales fell 0.4% in December and fourth quarter real GDP appears to have grown at a subdued 1.5% annual rate. It is also true that in the past six months manufacturing production has been flat, new orders for durable goods have fallen at a 0.8% annual rate and the unemployment rate has blipped up to 5.0%. Soft data for sure, but nowhere near the end of the world.

It is most likely that this recent weakness is a payback for previous strength. Real GDP jumped 4.9% at an annual rate in the third quarter, while retail sales surged 1.1% in November.

Just a year ago, most economic data looked much worse than it does today. Manufacturing production fell 1.1% during the six months ending February 2007, while new orders for durable goods fell 3.9% at an annual rate during the six months ending in November 2006. Real GDP grew just 0.6% in the first quarter of 2007 and retail sales fell in January and again in April. But the economy came back and roared, with real GDP averaging 4.4% growth between April and September 2007.

A weak housing market helps explain recent softness in production and durable goods orders. But housing is now such a small share of GDP (4.5%) and it has fallen so much already, it is highly unlikely to drive the economy into recession all by itself.

Exports are 12% of the economy, and are growing at a 13.6% rate. The boom in exports is overwhelming the loss from housing. This can be seen in the fact that initial claims for unemployment insurance have averaged just 314,750 in the past four weeks, and are currently 301,000, a far cry from recession.

Personal income is up 6.1% during the year ended in November, while small business income accelerated in October and November during the height of the credit crisis. In fact, after adjusting for inflation and then subtracting income taxes, and payments on rent, mortgages, car leases/loans, credit card interest, and property taxes, real personal income is up 3.9% during the year through September.

Commercial paper issuance is rising again, as are mortgage applications, Libor spreads have returned to more normal levels, while commercial and industrial loans are up 29.7% at an annual rate in the past six months. In addition, firms and sectors of the economy that have experienced large declines in equity values, or large losses, are attracting capital from private and foreign sources. Presumably, these buyers and investors are well aware of the problems that exist, yet see great opportunity.

In other words, not only is a recession unlikely, but it appears capital markets are already deep into a process that will lead to a full recovery of the financial system. When combined with rapid and large cuts in the federal funds rate, the economy is poised to grow rapidly for the remainder of 2008.

ARE FED RATE CUTS ENOUGH?

The Federal Reserve has cut the federal funds rate from 5.25% to 3.5% in the past five months. The most recent rate cut, of 75 basis points on January 22nd, was the largest single Fed rate reduction in a quarter of a century.

The federal funds rate is now well below the trend rate of nominal GDP growth. In addition, with the consumer price index rising 4% during the 12 months ending in December, the real (or inflation-adjusted) federal funds rate is now negative. In other words, monetary policy is highly accommodative.

This alone should be enough to hold off a recession. Every single recession since 1913 has been associated with overly tight monetary policy. As a result, the probability of a recession at the current time is much less than many fear.

The argument that "this time it is different" is not overly compelling. Yes, it is true that many money center banks in the US have seen their capital eroded, and it is also true that credit markets have been dysfunctional.

However, there are an infinite number of channels in which the money multiplier process can work. Even if some large financial institutions are impaired, other well-capitalized regional and community banks who did not participate in the sub-prime loan market are still lending. Private equity firms and foreign investors also have liquidity as do non-financial corporations in America with more than $1.1 trillion dollars in liquid assets.

IS MORE STIMULUS NECESSARY?

Fears that current financial market problems could spread and create a Japanese-style market crash, credit crunch and economic downturn are remote. The Japanese central bank continued to hike rates in 1990, even after their stock market had fallen sharply. And it took three years before Japan's short-term interest rates fell back to even 1988 levels. Japan also lifted tax rates during this time of extreme market uncertainty. The result was a deflationary recession.

Today, in the US, monetary policy is nothing like that of Japan in the 1990s. In fact, the risk of an overly loose policy that creates inflation is much larger than a recession caused by excessively tight policy.

Moreover, other fundamental drivers of economic growth are still solidly in place. Tax rates remain relatively low, and productivity is growing strongly. The entrepreneurial side of the US economy remains healthy.

And because recent Fed rate cuts will take roughly six to nine months to affect the economy, by the time any rebate checks could be in the hands of consumers, the economy will already be accelerating.

As a result, the stimulus plan, because it will increase the budget deficit in 2008, will engender rising expectations of future tax hikes. This concern will lead to a reduced willingness by US and foreign investors to invest in long-term projects which could create jobs and lift growth in the US.

Congress should consider three other issues when making a final decision on whether to pass fiscal stimulus. First, it sends a mixed message. Yesterday, many analysts and politicians were worried about excessive consumer spending, a lack of saving, exploding debt levels, and federal budget deficits. Today, these arguments seem forgotten as we run full speed ahead with plans to encourage more borrowing, and consuming, while at the same time running up the budget deficit.

Second, rebates will not change the long-term path of the US economy. Consumers make decisions about spending based on their long-term income expectations, not on their current income. A rebate will not change long-term spending habits. Moreover, no retailer or manufacturer is likely to build another outlet or manufacturing facility based on a temporary consumer-oriented stimulus. In other words, temporary stimulus does not create new jobs or investment.

Third, while I do not subscribe to the view that budget deficits increase interest rates, it is clear that government spending crowds out private investment. The money to send rebate checks in 2008 will need to be borrowed. Therefore, the very funds necessary to pay for this increase in consumer spending will reduce the availability of funds in other parts of the private sector for investment. This would be counterproductive at a time when markets are in turmoil and many financial institutions are in need of low cost capital.

IS THERE ANYTHING ELSE THAT WOULD HELP?

Yes. The expected sunset of the 2003 tax cut in 2011 is becoming a real impediment to long-term investors. As an active participant in the US financial markets, I already hear on a daily basis how the potential of higher tax rates is reducing the incentive to invest today.

The stock market is especially at risk. If the 2003 tax cuts are allowed to expire, the real cost of capital for American corporations will rise by at least 1%. This, in turn, will result in a 20% drop in US equity valuations.

A key determinant of long-term economic growth and rising asset values is stability in the value of money, the political environment and with future tax rates. If passing a stimulus package now increases the odds of tax hikes before 2011 because it lifts the deficit in 2008 and 2009, this would act as an offset to any positive impact of a stimulus package.

In addition, as we can see in record-high gold prices and a falling value of the dollar, inflationary pressures are already on the rise. As a result, it seems clear that recent interest rate cuts will be reversed at some future date.

A reversal of recent accommodative monetary policy along with rising odds of tax hikes could hurt the economy at some point in the years ahead. In other words, policy actions to help the economy today could very well have a negative impact in the future.

As a result, it is important that current policy be designed with long-term economic activity in mind. I propose three policy changes that would boost investment, innovation and productivity in the years ahead and help offset the virtually certain shift in monetary policy toward a more restrictive stance.

1) Make permanent the Bush tax cuts of 2003.
2) Cut the corporate tax rate to 25%.
3) Index capital gains to inflation for taxation purposes.

These three proposals will boost America's competitiveness, lift entrepreneurial activity and create a vibrant, long-term growth path that will be less inflationary, and more resilient.

Chairman SPRATT. Dr. Summers, would you respond to that point of view with respect to the status of the economy in particular? Are we selling the economy short? Is it actually in better shape than it seems to be?

Mr. SUMMERS. I think Mr. Wesbury does a very good job of stating the case against a stimulus package, but I think his judgments address what strikes me as being a small probability rather than the preponderance of evidence, for the reason that he essentially acknowledges when he recognizes that the kinds of statistics he cites are inevitably backwards-looking rather than forward-looking.

The housing sector is in serious trouble. We got numbers yesterday suggesting that it was even worse than we supposed. Yes, housing construction is only 4 percent of GNP, but housing wealth is the largest asset for most American consumers, and its value affects their ability to spend. The availability—what is happening in the housing market affects the ability of the financial system to provide credit. And it is those contractions in credit that those of us who are concerned about the economy see as most likely to slow and derail the economy.

Insofar as GNP expands because we accumulate inventories, that is a basis for predicting slower GNP growth in the future, not more rapid GNP growth in the future. If one looks at what I think is relevant for policy, which is expected future inflation which we now—if I can put in a plug for something that we did in the 1990s in the Treasury, we now—because of the existence of inflation protection bonds, TIPS, are able to construct the market measure of inflation expectations, and what is striking is that inflation expectations have come down rather than risen. So I think it is a mistake to be overly distorted by the transient evidence that comes out of looking in a backward-looking way at the CPI.

So I think what one wants to do is look at the experts who have updated their forecasts most recently, who now regard a recession as the preponderant probability. But above all, one wants to ask this question: Suppose that we should have done stimulus, and we didn't? Then we are taking, I believe, a real risk with respect to economic performance over several years, and we are taking a risk of allowing a situation in which the economy turns down, and that exacerbates the problems in the banking system, which causes the economy to turn down further. And we are running the risk of having the type of situation that plagued Japan for most of the 1990s.

If, on the other hand, Mr. Wesbury is right and the alarm here is excessive, the Fed will stop easing sooner than it otherwise would have. We will avoid some of the distortions associated with low interest rates, and there will not be any very large loss.

So, as Alice Rivlin recognized in her testimony, any judgment of this kind must involve a balancing of risk. And I would share her judgment that the risks of not acting, if the economy is turning down, are far greater than any risks of excessive action.

Finally, Mr. Chairman, I would just note that, for reasons that I suspect members of the committee can imagine, I would entirely dissent from Mr. Wesbury's analysis regarding the consequences of making the tax cuts permanent and so forth, which, in my judgment, would be quite counterproductive for economic performance.

Chairman SPRATT. Dr. Summers, one more question.

This is not, apparently, if we are faced with a recession, your garden variety, postwar, cyclical downturn. It has got structural origins; namely, the housing market, the subprime market, the mortgage market generally, and you just mentioned—and so did Mr. Wesbury—that housing equity is a major source of wealth for American households.

If the problem here is a decline in consumption—consumer demand—due to the fact that that wealth, source of wealth, is diminishing, can we counteract that with a countercyclical policy in the form of rebates to consumers, onetime rebates to consumers?

Mr. SUMMERS. Yes. We can respond to the fact that we are in a period where it is going to be very difficult for anybody to borrow against their houses by providing them with some cash to enable them to keep spending. We can respond to the fact that people are, to use the economic jargon, “liquidity-constrained” by providing them with a certain amount of liquidity through the rebate, and the evidence is that most of that money will be spent. It is a different kind of recession in some respects, but it is the—it was sort of Keynes’ central insight 60 years ago, that is still to the point today, that there is actually a free lunch in economics, and it comes from providing enough demand to avoid a recession. And in a situation where people don’t spend and therefore people don’t have jobs, and people don’t have jobs and therefore they don’t spend, can be avoided by priming the pump and generating some spending that allows some confidence to return and allows a higher level of employment and output while a process of financial repair is taking place. And that is the theory behind the stimulus, which again, I think, the balance of risks very much supports.

Look, you all are in many ways closer to the front lines of the economy as you return to your districts than I. But as I look at the statistics and as I travel around, I don’t detect an enormous number of labor shortages, bottlenecks, people working past capacity, and that the danger that we are going to overheat or overstimulate the economy certainly doesn’t seem to me to be the paramount danger that we should be worried about at this time.

Chairman SPRATT. Thank you very much.

Mr. Ryan.

Mr. RYAN. Thank you, Chairman. I have so many questions. I’ll try and limit them.

One of the reasons why I wanted Mr. Wesbury to come testify is because I think it is always good to have a contrarian among our witnesses. That serves us as policymakers better.

Also, Mr. Wesbury, you have an impressive forecasting record. Your livelihood depends on your ability to forecast. I think you won The Wall Street Journal Economic Forecasting Award in 2001 because you were one of the few economists to actually predict the recession in 2001. USA Today names you one of the top ten forecasters.

We just heard from Dr. Summers sort of the demand side of it all. Give us just in a truncated answer, briefly, why you are not forecasting a recession this time, and how is that different than the one you forecasted in 2001?

Mr. WESBURY. Sure. The most important input into my models—and the reason that I was able to forecast a recession in 2001—is monetary policy. Real interest rates in 2000 were very, very high. We had a 6½ percent Federal funds’ rate with about a 1½ percent inflation rate. That means the real rate was well over 4 percent. Today, the Federal funds’ rate is 3½ percent. The inflation rate is 4 percent. And by the way, TIPS bonds have been a lousy predictor of inflation for 4 or 5 years, but that is the big thing, and that is why I am predicting that we will not have a recession today.

Mr. RYAN. Now, let me just go over the monetary policy for a moment, just because we have such esteemed people.

Dr. Rivlin, I think—weren't you the Vice Chairman of the Fed in the late nineties?

Ms. RIVLIN. Yes, I was.

Mr. RYAN. Yes. And obviously we know, Dr. Summers, your pedigree. Let's go into that for a second.

Let me read from a column today by Robert Samuelson—hardly someone those of us on the right quote—the last two paragraphs of his op-ed in the Washington Post today.

"The Fed's first responsibility is to keep inflation at low levels because, without that, its other goals of maximum economic growth and low unemployment become impossible. We learned this lesson painfully in the 1960s and the 1970s. Political pressures, then, to avoid all recessions led the Fed to relax money and credit too often. The perverse results were higher inflation and more frequent and harsher recessions. Annual inflation peaked at 13.3 percent in 1979 and annual unemployment at 9.7 percent in 1982. * * * some economists think the Fed is already repeating its previous error, now prodded by market pressures and the specter of financial panic. If the market constantly demands to be stimulated by lower interest rates and easier credit and threatens to go into an uncontrollable tailspin if it isn't, then the Fed is in a treacherous position. Trying to make matters better now may make them much worse in a few years if higher inflation emerges. This danger is easily overlooked."

I just did 15 town hall meetings in Wisconsin, Secretary Summers, and there is a concern about the economy. But back home, there is also a concern about prices—the cost of living, health care costs, energy costs—in our area, particularly home heating costs, gas price costs. So the prices people especially living on fixed incomes, namely seniors, are experiencing are really eroding their standard of living and their income. And so my fear is are we trading a couple quarters of slow growth for a couple of years of inflation? Because if we bring inflation into this economy, it is going to take a long time to wrench it out of the system. It is going to be a painful stepping on the brakes that will occur from the Fed. And then all those people who are living on fixed incomes today, seniors—we have a whole bunch of baby boomers beginning to retire. Their standard of living is permanently diminished and eroded. Their ability to live on fixed income and maintain that standard of living is gone.

So the question for those of you who have such good monetary policy experiences: Is the TIPS bond a relevant and timely predictor? Does the Federal Reserve now, in this era of instantaneous information exchanges, really have the ability to not only predict inflationary expectations but to make changes before they actually become embedded in our economy? And is there a risk here that we are going to overplay our hand and bring about inflation?

Let's just go Dr. Summers, Dr. Rivlin—and Mr. Greenstein, do you want to comment? I don't know your monetary background—and Mr. Wesbury.

Mr. SUMMERS. Mr. Ryan, I have been since long before I came to Washington a staunch supporter of an independent Federal Reserve, a major believer in the doctrine that inflation in all sorts of ways is harmful to the function of the economy. If I thought that a fiscal stimulus program would risk taking us 15 percent of the way back to the 1960s, it would be something that I surely would not favor.

I believe that as the Chairman indicated, we are looking at a very different structure than we have in the past. In the past, recessions have typically been caused when the Fed raised real interest rates in an effort to keep inflation under control. The situation we face today is quite different. The source of the instability is the asset bubble that took place and the strains that have developed in the financial system. And when there is no longer a demand for credit because the housing bubble is collapsing and people cannot be confident as to what is going to happen to assets, that is when interest rates fall, and that is why we have seen an abnormally low level of interest rates.

We face a kind of price discipline from imports from China and other countries. It is unlike what we have seen in the past, for reasons that relate closely to the increase in equality we have seen. We face much less capacity of workers to bargain for higher wages than we have seen in the past. Whatever you think of—whatever one thinks about the health care system, it doesn't have its roots in anything to do with monetary policy.

Indeed, I believe that failure to enact the stimulus program would in all likelihood place more of the burden of preventing financial collapse on monetary policy, would lead interest rates to be lower than they otherwise would be, would risk a recycling of the kind of experience we had before with extremely low interest rates——

Mr. RYAN. Can I ask you——

Mr. SUMMERS [continuing]. Which would mean higher oil prices, a weaker dollar, higher commodity prices, and more risk of asset-priced bubbles in the future.

Mr. RYAN. Is that observation based on sort of a psychological observation and, "We are two-thirds of the way down the road on this, and if we pull back now, then that would occur"? Is that the premise of that observation?

Mr. SUMMERS. No. That observation was part of the argument I advanced in advocating a stimulus package 2 months ago before you were on the road. And, frankly, I would not have expected at the time that you would have moved as rapidly as you have. And so I have been very gratified by the response of the Congress.

But it has been my view all along—I argued it in the Financial Times some time ago, and some similar arguments were made this morning by Alice Rivlin—that responding to the economy in a balanced way with both fiscal and monetary policy would provide for a much more healthy response than relying only on monetary policy, which would be likely to come with all the defamations that would come from an extreme monetary policy. And that the risk would be that if you don't have this fiscal stimulus, the Fed will have to cut even faster, and then those very low interest rates feed through in kinds of ways you spoke of, to commodity prices and all of that.

And so I think if one is concerned about financial stability, concerned about the dollar, concerned about commodity prices, then one wants to have a balanced response to this problem with both fiscal and monetary policy rather than relying only on monetary policy.

Mr. RYAN. Dr. Rivlin?

Ms. RIVLIN. I think the Fed is in a tough spot right now, and I suspect that they are weighing the inflation risk very carefully. They are always in a position of balancing, but the balance is especially difficult right now because we have had the upward pressure on inflation from energy prices and, recently, food and commodity prices. But I don't think that they will. In that discussion, one should weight the possibility of inflation taking off, as you said, very heavily. We have not seen that.

I was at the Fed in the late 1990s when we were truly mystified by what was happening in the economy because it was growing so fast and because unemployment was so low, it got under 4 percent at some point, and all of the Fed's staff were running their models and saying, "You got to be careful, you are going to have inflation, you ought to raise interest rates," and inflation did not happen.

And we've also seen, in this more recent period, a big run-up in oil prices that any economist would have predicted would pass through to consumer price indexes, and it has basically not happened. Now, I think that is for the reasons that Larry cited. We are a much more flexible economy than we used to be. We use less oil per GDP created. We are subject to a lot of downward pressures on inflation on both wages and prices from global competition. So we're just not in a position where inflation might suddenly take off, which was the worry in the 1960s and 1970s; it is not now.

I am not dismissing the inflation worry, but the other thing the Fed does have to worry about, if it overdoes the monetary stimulus, is another asset price bubble of whatever kind. They are certainly being blamed now in retrospect for having gotten interest rates down so low that it stimulated the housing bubble. They don't want to be in that position again.

So I think the fiscal stimulus is, as I said in my testimony, partly insurance against the risk of recession and partly to take the burden off the Fed so they don't have to lower it as much as they otherwise would.

Mr. RYAN. It seems the experience of the 1990s has sort of disproven the Phillips curve. I'm not going to get into asking you to comment on that, but——

Ms. RIVLIN. Thanks.

Mr. RYAN. Because I think I know your answer. But on to the measurements we use to predict inflationary expectations—the Michigan consumer survey, TIPS bonds—in your opinion, are those accurate enough and do they give the Fed enough running time and enough of a fair warning to act accordingly to prevent those expectations from embedding themselves into the economy?

Ms. RIVLIN. I don't think we know much about how to predict inflation and inflation expectations. I am very glad that the Summers Treasury created the TIPS, but they are not, as Mr. Wesbury said, a very good predictor.

Mr. RYAN. No offense, Bob. I just want to skip to Mr. Wesbury because I want to be judicious with my time, and I just have one quick Fannie-Freddie question I want to ask Dr. Summers.

Mr. WESBURY. The reason I said TIPS have not proven to be a very good forecaster is 4 and 5 years ago they were saying we would have about 2 percent inflation. In fact, inflation has averaged over 3 percent.

We don't have a lot of long-term data, but I just look at the last 4 or 5 years. If you would have bought a TIPS bond 4 years ago, you would have done much better than a nominal Treasury bond because they were underestimating inflation by a large amount.

I want to go back to something Dr. Summers says, and that is that suppose that we should have done stimulus and we didn't. This is always a serious question that you have to wrestle with. But one of the things that I would like to point out—and your reading of the Samuelson piece in I think it was The Washington Post today points this out—that if you go back to the 1970s, I believe we got into a situation where we were always—I call it the tyranny of the urgent. We were not looking down the road and providing long-term policy. We were cutting interest rates to help the economy one time, raising interest rates to fight inflation the next, doing stimulus packages, trying to manipulate the economy. And this always, I believe, leads to an unstable environment. And that is bad for business and bad for the economy.

And then one last quick point. John Maynard Keynes believed that the economy was not stable on its own, that it had to have government put guardrails up and keep it on the path, otherwise it was going to drive into the ditch at any moment. And I don't believe that. I believe that the U.S. system and U.S. businesses and U.S. consumers are more rational and better decision-makers than John Maynard Keynes believed, if that is the way we want to characterize his thoughts, and that, in fact, government action, more often than not, in fact makes things worse.

And that is one of the things that I would say today, is that one of the reasons we are where we are today is because we drove interest rates down to 1 percent between 2003 and 2004. In 2002 they were very low as well. And that led to a huge explosion in risk-taking and leverage in the market and subprime loans and lots of decisions by people based on an extremely low interest rate that was not real, was not realistic. And then when interest rates went back up, all of those decisions now look bad.

And so here we are going to try to give a little, I call it hair of the dog; let's give more low interest rates to fix this. And I believe that can cause even more problems down the road.

We see it in gold prices. Gold is at an all-time record high. Oil prices are back to where they were in the late 1970s, early 1980s. The value of the dollar has plummeted. We have even lost—the value of the dollar has fallen over 25 percent in the last 2 years against the Albanian lek. All right? The reason that is, it is not because of budget deficits. It is not because our economy is tanking. It is because we have printed too many dollars. And when you print too many dollars, just like if you have a bumper crop of corn, the corn price goes down, the value of the dollar goes down. If we have a bumper crop of dollars—and that is the fear that I have, is that an overreaction to a problem that will fix itself will create more problems down the road.

Mr. SUMMERS. There is a line of thought that holds that sometimes people smoke in bed and that if you just got rid of the fire department they would be more responsible and you wouldn't have fires. And that is the kind of thinking that I think we are being exposed to here.

I want to be very clear. I believe that a course of action that would avoid reducing interest rates, because we didn't want to have bubbles, and avoid having fiscal stimulus, because we didn't want to stimulate the economy excessively and have inflation, that, frankly, that was the kind of thinking that made the Depression "great." Obviously, our situation now is not parallel to the Depression. But the policy thinking in 1930 and 1931, after you had a financial bubble burst and you had substantial problems in the banking system, was essentially of the same kind: "gosh, we can't inflate. Gosh, we have to make sure that our currency doesn't lose its value. Gosh, we have to just let the purging take place." And the consequences were catastrophic. And I don't think that is a risk that we can prudently take.

Frankly, I believe strongly that fiscal stimulus is a good idea. I understand the argument that it would be better not to have fiscal stimulus and to rely only on monetary policy. But the argument that Mr. Wesbury is making, that we should just rely on the natural restorative forces of the economy to work this situation through, I think really is a prescription for turning a serious situation into a critical situation.

Mr. WESBURY. For the record, I do not want to get rid of the fire department.

Mr. RYAN. This could go on and on and on. And I question, sort of, the characterization of the Samuelson point of view and others.

I want to yield my time.

I just want to get quick, Dr. Summers, Fannie and Freddie, should we be lifting the loan limit without any commensurate regulatory reform, more transparency, a stronger regulator? You were very vocal at Treasury about having a stronger regulator on the GSEs. Is it a good idea to raise their loan limits without any increase in transparency or regulatory accountability?

Mr. SUMMERS. I think what would be best would be to see the issues addressed simultaneously and together. I think there is a need—I think there is a critical need for reform where the GSEs are concerned.

Mr. RYAN. Thank you.

Chairman SPRATT. Ms. DeLauro.

Ms. DELAURO. Thank you very much, Mr. Chairman.

And I want to thank our panel this morning for their testimony.

I just want to say, as a Member of this body, that I've been really quite pleased at the way, on a bipartisan basis, that this Congress and this administration have come together in trying to listen very carefully to the preponderance of economic information that says that we have long-term difficulties and what we need to do is to try to engage in both monetary and fiscal policy and that, in fact, a stimulus package that would be targeted, timely and temporary would be effective at this moment. We moved, we moved quickly, especially on the House side. And I am a strong supporter of this effort, though my own views on employment insurance and on food stamps and, Dr. Rivlin, even on infrastructure, I will put those aside for the moment because I don't want to see a delay. I want us to move, because I think that that is what we owe the American people.

Two questions, if I can get both of them in. I am not going to go through what is in the package. Some have said that—it is argued that the rebates are too small to make a difference. At least three out of four have dealt in a different way with that effort.

My question, one, is on the child tax credit, the $300 child tax credit. And if you believe that the child tax credit represents an important component of a stimulus package, would permanently expanding the child tax credit so that families who need it the most, lower-middle-class working families, receive it and that would help the economy? And as part of that, your view on your support for refundable tax credit as part of broader economic policy for the future. Let me lay that one out.

The second—and, Dr. Rivlin, you mentioned the infrastructure piece in terms of the short term and the lack of payout. With regard to infrastructure as national policy for the future, in terms of long-term rebuilding our economy—and I would love to get people's views as to what you think about that. And that is not the short-term stimulus piece, but long-term.

Let me leave it there. And, first, let me get your views on permanency on child tax credit and refundability. Dr. Summers?

Mr. SUMMERS. Congresswoman DeLauro, I believe the refundability component of the current stimulus is very valuable. I think it is an important milestone in tax policy that there has been agreement on a bipartisan basis on the principle that any important tax incentive should be made refundable. I think that is a very important step that I salute.

I do not believe that, as part of a stimulus bill, anything should be made permanent——

Ms. DELAURO. I am not talking about the stimulus bill.

Mr. SUMMERS [continuing]. In the absence of PAYGO, because that would violate the principle of timely, targeted and temporary.

Ms. DELAURO. Right.

Mr. SUMMERS. Over time, as Congress addresses tax policy, recognizing the need for pay-fors, I would very much like to see the child credit that you mention be a part, on a long-term structural basis, of the tax system.

I might add, because although you didn't raise it explicitly I think it is responsive to your concerns, that I would rather see the child tax cut be larger and the stimulus tax rebates be available only to those with incomes below a cap, such as $150,000, as is contained in the House proposal, than to see the cap removed and the size of the rebate reduced, as I understand is under discussion in the Senate.

In the long run, with proper pay-fors, I think we do as a country need to invest much more in infrastructure. Look at Katrina, look at what happened in Minneapolis, look at the opportunities for maintenance.

I would say that I am somewhat skeptical of the some of the proposals that emphasize innovative financing, because I don't think finding the capital is really the crucial issue. And some of the proposals that emphasize innovative financing I think are really backdoor routes to changing the way we do deficit accounting in ways that I would be uncomfortable with. But more paid-for infrastructure spending, yes, absolutely.

Ms. DELAURO. Dr. Rivlin?

Ms. RIVLIN. I agree with all of that. I do think the refundable child tax credit should be an important part of permanent tax law, but don't do anything permanent in the stimulus package.

I also agree on infrastructure. I think we have shortchanged our public capital over quite a long period, and there are statistics to back this up. We need better transportation. We need an investment in our school buildings. You can name a lot of things that we are shortchanging. We have done a lot of private capital and not nearly enough public capital over the last few years, and I hope that that changes.

Ms. DELAURO. Mr. Greenstein?

Mr. GREENSTEIN. As you know, the current child tax credit has a partially refundable component, but families with children that have earnings below $11,750 a year do not qualify for it. And I think, if I understand your question correctly, what you are referring to is that in the stimulus package families will begin to qualify for something in that area at $3,000 of earnings as opposed to $11,750 of earnings. And I definitely think that that kind of a change is positive and would be desirable over the long run, but only, as Larry and Alice have said, separate legislation, fully paid for.

Ms. DELAURO. That is what I am talking about.

Mr. GREENSTEIN. Having said that, when we ultimately do tax reform, if we do, I think it would probably be useful to look at whether a more fully refundable child tax credit and the current earned income tax credit ought to be integrated in some way so that we have one larger, well-designed credit that is both more ample—better work incentives, fewer marriage penalties—than sort of having two that somewhat unevenly fit together.

Final comment. Larry mentioned that the Chairman's mark in the Senate reduces—it is a slight reduction, reduces the maximum size of the rebate and extends the rebate to families above the caps that the House has. I think if you look at the changes in the Chairman's mark in the Senate, it slowly lowers the rebate, and it puts the money in three places. One, it, as I mentioned, makes the rebates uniform for families above $3,000 a year, so that the working poor families don't get maybe half the rebate a family at $100,000 or $150,000 gets. That should improve the stimulative effect. Instead of only covering middle-income elderly, it also brings in low-income elderly. That probably also increases the stimulative effect. And it removes the cap at the top, and that clearly decreases the stimulative effect.

But I just wanted to note that there are three changes. Two would increase the stimulative effect; one would reduce the stimulative effect.

Mr. WESBURY. Congresswoman, this is not my area of expertise. I would second, however, one of the comments just made about tax reform in general. I think that our tax system, being as complex as it is, actually diminishes long-run investment in the United

States. So to the extent that any of these rules can be written into the code in a much less complex way, I think we would benefit a great deal.

Ms. DELAURO. Thank you.

Thank you, Mr. Chairman.

Chairman SPRATT. Mr. Hensarling.

Mr. HENSARLING. Thank you, Mr. Chairman.

First, let me concur with my colleague from Connecticut. We do appear to be in a moment of rare bipartisanship. I think, listening to the comments of our colleagues, bipartisanship might be defined as very few of us like this legislation but almost all of us are going to vote for it.

Dr. Summers, I have a question for you, and that is—I plan to support this legislation, not because I am convinced that it will necessarily have a stimulative effect on the economy. As I observe in the Fifth Congressional District of Texas, middle-income families are having their paychecks squeezed by high gas prices, high energy prices, high health-care prices, and I always champion the cause of allowing hard-working families to keep more of what they earn.

But if the theory is that roughly $100 billion of tax rebates, some to people who pay income taxes, some who don't, is going to promote consumer spending and thus boost our economy, why is the reverse not true?

You have come out in your testimony against foreclosing the scheduled tax increases that are due to arise from the expiration of the 2001 and 2003 tax relief. Those automatic tax increases, combined with other tax increases that might be imposed—the Chairman of the Ways and Means Committee has proposed an AMT proposal—combined with the two, 90 percent of all Americans could see their taxes increased.

So I'm just curious, if we sit here over the next 3 years and tax the American people to such an extent, why is that not going to contract the economy if $100 billion of spending now is somehow going to boost the economy?

Mr. SUMMERS. For two reasons, Congressman.

First, most of the time, the economy is effectively—resources are fully employed or relatively fully employed in the economy. And so the only way you increase the scale of the economy is to change the potential of the economy to produce. And simply increasing demand will simply lead to a higher rate of inflation.

We now face the unusual circumstance that the economy faces in about 1 out of every 7 years historically, recently, where there will be significant unemployed resources and a significant shortfall in capacity and that, by increasing demand, we are able to increase use of resources.

So, normally, stimulating demand is not availing. At the current moment, we are at the relatively rare moment when it is.

Second, insofar as it is desirable to stimulate demand, as both Alice Rivlin and I and Bob emphasized, tax reductions have to be targeted. And the calculations that have been done with respect to the tax cuts that some propose to make permanent 3 years from now is that the vast majority of the revenue goes to a rather small minority of the citizens who are the people who are already with the largest pools of liquid assets and who, therefore, are very unlikely to spend at any rapid rate out of any reductions and revenues that they are given.

So it is both that demand-side stimulus on a permanent basis is not a very good idea, and if it was, repeal of the tax cuts would not be the right way to accomplish demand-side stimulus.

Mr. HENSARLING. Thank you.

Let me move on since my time is limited.

Mr. Wesbury, what do you believe would be the impact of our economy if we signal that these automatic tax increases would not take place on families and entrepreneurs?

Mr. WESBURY. Let me just say that I operate in the financial markets. Our customers are financial advisors all over the country. And one of the biggest questions I get is, are tax rates going to go back up in 2011 or before, and what is the probability of that? That will affect the equity markets in a dramatic way.

And let me point out that the 2001 recession and, in fact, every recession in the post-war period has been a business-investment-led recession. Consumers really don't lead us into recession. In fact, consumer spending continued to grow at about a 3 percent real rate right through the 2001 recession. It was a massive decline in business investment that caused the recession of 2001. And so, if you really want to keep the economy out of recession, you ought to focus on business investment, not on demand or consumer demand. I think that is pretty clear from history.

So I think allowing those tax cuts to expire increases the risk to investment, and it will reduce it today. And as a result, as we get closer, the uncertainty will rise, and I think that is harmful to investment.

One last point. I will repeat it; I said it before. That tax cut in 2003, because of its cut in capital gains taxes and dividend tax rates, reduced the cost of capital to American corporations by about 1 percent—that is a significant reduction when you are looking at a cost of capital in the 5 to 6 or 7 percent range—which boosts the underlying value of equities by about 20 percent. Allowing it to reverse will reverse that process.

Mr. HENSARLING. Thank you.

Ms. RIVLIN. Could I make a quick point in this connection?

This discussion of what effect tax rate changes have on the economy can't be had in the abstract. You also have to look at the spending side. The effect of making the tax cuts permanent depends on what you do about permanent spending. And right now we have built-in spending that greatly exceeds the revenues, even if we don't keep the tax cut. That is the problem.

Mr. HENSARLING. Thank you.

I see I am out of time. Thank you, Mr. Chairman.

Chairman SPRATT. Mr. Edwards.

Mr. EDWARDS. Dr. Summers, Dr. Rivlin, Dr. Greenstein, each of you have said you support a stimulus package. Each of you has said there are ways that you could personally improve it, or you would suggest improving it. And you have also said timeliness is key. So that raises, to me, the fundamental question of where we go from here.

We have President Bush and Speaker Pelosi, who have agreed on a bipartisan stimulus package. The House will most likely pass that today. Even given your ideas and comments today that the package could be improved, given my concern that Congress better not let the perfect be the enemy of the good when it comes to stimulating this economy quickly, what deadline would you suggest to Congress so that if, for example, the Senate in its deliberations comes up with ideas that maybe the four of us would agree to but President Bush won't sign, what is the deadline by which Congress should have a stimulus package on the President's desk that he would agree to sign, in order to have the best chance of either preventing a recession or mitigating the impact of a possible recession?

Dr. Summers, if you would begin.

Dr. SUMMERS. Two weeks from now.

Mr. EDWARDS. Two weeks from now.

Dr. Rivlin?

Ms. RIVLIN. Yesterday would be better, but 2 weeks from now would be fine.

Mr. EDWARDS. All right.

Dr. Greenstein, you mentioned the President's holiday recess. What specific date?

Mr. GREENSTEIN. I would generally concur with the 2 weeks from now, but I would like to have a caveat. And the caveat is that on the package as it is currently designed, waiting another couple of weeks probably doesn't make much difference for the following reason: Whether you enact the package before you go home for President's Day weekend or 2 weeks after that, the rebate checks still can't go out until the end of May. The problem of the rebate checks not being able to go out until then is not solved by a couple of weeks' difference in enactment. It has to do with IRS's ability to use the 2007 tax return data in order to develop the rebate amounts.

And, of course, the particular reason, one of the key reasons why I am hoping both that the Senate can very quickly include unemployment insurance and food stamps and that that can be accepted hopefully and enacted quickly into law, is they are the two elements that can take effect much faster than the end of May, and that is of help.

So when you say how fast do we have to act, on the one hand actually including those two elements, even if it took an extra week, would increase the immediacy of the effects than going a week earlier and not having those key pieces in it.

Mr. EDWARDS. Thank you all for that answer.

Would you each agree that if there is an apparent stalemate between the Senate and the House or between the House, Senate and the White House, and it looks as if this process could drag on for over a month, do you believe that would be harmful in our efforts to try to stop a recession from occurring?

Dr. Summers?

Mr. SUMMERS. Yes.

I would agree with the analytics behind what Bob said, but I would emphasize two points. One, the passage of the plan and the knowledge that the rebates are on the way is confidence-injecting even before the rebates arrive.

Second, my experience watching the Congress is that every day that things remain open is a day when something can come along that scrums things up and drives things toward deadlock. And, therefore, I think it is the better part of valor to be using 2 weeks from now, which I had calculated to roughly correspond to when I expected you would be recessing for President's Day, as a deadline.

Mr. EDWARDS. Dr. Rivlin, would you like to comment?

Ms. RIVLIN. I agree with that, but I think there is an additional reason. The American people need confidence that their Government can do something. And this has been a really exciting thing for those of us who watch the U.S. Government to see, finally, finally, the Congress and the President seem to be, A, talking to each other and, B, negotiating a package that might pass. I would not jeopardize that for minor improvements, although all of the things that Bob Greenstein said are right.

Mr. EDWARDS. Dr. Greenstein, you commented earlier. Would you care to add anything to that?

Mr. GREENSTEIN. Yes. To clarify, something that took a month or more to work out would really be a bad idea. I very much agree with Larry and Alice on that. I would try your best to get it done before the President's Day recess. I would have as my absolute drop-dead date the end of February. This should not go into March.

Mr. EDWARDS. Thank you.

Thank you, Mr. Chairman.

Chairman SPRATT. Mr. Conaway.

Mr. CONAWAY. Thank you, Mr. Chairman.

I appreciate the witnesses being here today.

This is an odd conversation to sit and listen to. I have heard this package described as taking a five-gallon bucket of water out of the deep end of your public swimming pool and wandering down to the shallow end and pouring it back in.

I am hoping that, Alice, doing something, that the benefits of that aren't offset by us doing something wrong. We seem to have gotten to the need of this stimulus package rather quickly without a great deal of conversation as to whether we really do need it—more along the lines of Mr. Wesbury's comments.

But I guess the backdrop of a $53 trillion of unfunded promises to each other that we will have to renegotiate at some point in time, and not reform them, but renegotiate them, that said, your comments that, Mr. Summers, you said we have a very inadequate personal savings rate, Federal savings rate; that living within our means does not seem to be something we do well at the Federal Government level, at the family level; that the asset bubble that seems to be the bogeyman in all of this, that we are turning back to the asset bubble creation model of easy credit and greater spending to get ourselves out of what I guess the preponderance of economists would say is a, quote/unquote, "recession," it just strikes me as particularly odd that we are at this juncture. And we are. And like the rest of my lemming friends, I am going to go across the street in a little while and vote for this package and hope that it is not too bad in that regard.

I would like to have a head nod from each of the three that like the permanency of the child rebate, permanent food stamp increases, that you would nod your head that that should not be a part of this as well. Because raising food stamps for 20 percent or whatever it would be for 3 months or 4 months and then cutting those rates back to what they are right now I think would be politically difficult for most of us to do that.

Mr. Summers, you made a comment unrelated to this, that the tax rates that are currently in effect, should they go up, that the bulk of that revenue would go to the highest or the richest in our economy. It is just a difference of opinion. It is already their money. The Federal Government doesn't own it. We take it away from them at the point of a gun with our tax laws. And so it is just a phraseology more than anything else.

We also talk about fixing the State problems, Mr. Greenstein, by some transfer payment from the Federal Government to the States to help them avoid the fiscal medicine that is living within their means, balancing their budgets by them raising taxes or cutting expenditures. We transfer that wreck from the States in a very blunt, indelicate way to the Federal Government and the Federal taxpayer. And to the extent that it adds a buck to the deficit and long-term borrowings of this country, my seven grandkids and their grandchildren are pretty much loaded up as it is. And so it is just an odd conversation that we would have that we can somehow get ourselves out of what may or may not be a problem at all of these levels.

I don't really have a question. I try not to make these kinds of rants. I would rather ask questions, because you guys know a lot more about this than I do. But it just is an odd conversation where, on the one hand, we castigate Americans for not saving more and yet turn right around and give them money that they are supposed to spend. If you go to every morning show, "Today Show" or "Good Morning America," every one of those financial advisors that comes on tells that viewing public, "Start saving your money. Cut expenses. We are going into a wreck, and the way to help yourself out of that is to make sure you have your own fiscal house in order." And yet we at the Federal level just glibly say—and human nature is probably correct—that the bulk of this money will get spent within a relatively short period of time. But we add to the idea that you really don't have to save, that that is not really important in this country, that your Federal Government will come whistling in at some point in time and fix your effort.

So if you have a burning desire to say something, that is fine. Otherwise, I do appreciate your being here this morning and sharing your thoughts with us.

Mr. SUMMERS. I would say this, Congressman. I have a 25-year history of being for increased savings and being for strong market-oriented policies, and so I haven't come easily to this judgment. I would just invite you to consider that if we have a recession and that recession becomes serious and families are strapped, you are going to see much less savings than you otherwise would; that if you have a recession and that recession becomes serious, the Federal fiscal position is going to be twice as large a deficit as anything that people are talking about today, and that that is going to compromise our efforts to address all of these long-run problems. And so I think of this as a regrettable necessity to contain the risk of recession, which I think would compromise all of the various values that you spoke about.

Finally, I would just say that I understand your point, I think, about whose money it is and who pays the taxes. But as a factual matter as to what is going to impact spending and what is not, it is relevant to look at the propensity to consume of the people who will be affected by a given tax change. And if those people are people with very high incomes, whether it is their money or whether it is the Government's money, it doesn't really matter for this purpose. You are likely to be impacting people whose spending will be much less affected.

And so that is why I come to the judgment that preventing a recession is an imperative.

And, by the way, I suspect you, like me, are a major believer in the importance of open international markets. And I think that the prospects that the United States will maintain its commitment to open international markets, with all the benefits that they bring, will be substantially greater if we are able to avoid recession or we are able to mitigate the consequences of recession than if we suffer severe recession. So I come to the position I do from the perspective of wanting to have as well-functioning markets as we possibly can in our economy.

Ms. RIVLIN. Could I just add briefly to that? I share your feeling that this is an odd conversation. It is an odd conversation because we haven't addressed the long-run fiscal sustainability of the U.S. budget. If we had, then we would still be having a conversation about what to do in recession, about short-run policy, but it would be a much more comfortable conversation because we had fixed the basic problem.

Mr. GREENSTEIN. Could I just briefly add, since you mentioned—and I think this is a significant point, the food stamp question. If you had a temporary increase in food stamps, would they go down at the end of the period?

Let me just say, I have been involved, I think, with almost every piece of food stamp legislation and food stamp reform since 1973 and ran the program for President Carter. And my center and I are looked to in both houses by Members on both sides of the aisle when we design food stamp legislation. And I said to Members in the last few days of both parties and in both houses that the principle that anything in a stimulus package be temporary and expire on schedule is critical.

And for what it is worth, given my pledge and that of our center that we would oppose any effort at the end of the period to extend any temporary increase, everything should remain temporary, without getting too technical, there is also a way to lessen the cliff at the end of the period. There is a regularly scheduled October cost-of-living increase in food stamps. One could design a temporary increase now so that it takes effect in April or May, depending on the State, and operates in a way that you don't then have an additional COLA this October, and it actually would help with the overall design.

Mr. WESBURY. And let me make one quick comment. I agree with you, Congressman, that it is a strange conversation, is the way I put it. Yesterday we were telling everybody to save, and we were worried about the Federal budget deficit. Today we are telling everybody to spend, and we are not worried about the Federal budget deficit. And I understand that this is temporary, but it nonetheless adds to debt, it takes from one pocket and gives to another. And to the extent that Federal Government spending crowds out private investment, it actually hurts the very investment that we need to help fix the financial problems that exist today.

And I would point out that there is a tremendous amount of activity in the private sector right now to alleviate these problems. Warren Buffett is investing in financial institutions and insurance companies today. Wilbur Ross is buying one of the bond insurance companies and putting it on better capital footing. A triple-A rating is very important. Foreign sovereign funds are investing in our financial institutions, rebuilding their capital. There is $1.1 trillion in cash on corporate books that is coming back into the market to shore up the system. I believe the private sector will handle these problems and that we will not have a recession.

And then I would offer the opposite question that Dr. Summers asked, and that is, what if we don't have a recession? And I don't believe we are anywhere near one. And yet we have now lowered interest rates, run up the budget deficit, encouraged people to spend in order to fix one that doesn't exist. I think it creates problems.

One last quick point. The last 20-year average of the unemployment rate in the United States is 5.4 percent. Today our unemployment rate is 5 percent. If we were to extend unemployment benefits at this unemployment rate, it would be the absolute lowest unemployment rate by a long margin that we have ever done anything like that before. So we are setting a new bar for the extension of unemployment rate benefits, the extension of stimulus to the economy that has never been set before.

We are now interfering with an economy that is literally at full employment today. And so I do find this conversation strange. We seem to have reduced our tolerance for pain to such an extremely low level that I don't know how we don't react to almost any pain in the economy in the years ahead. And I think that creates problems.

Mr. CONAWAY. Thank you, Mr. Chairman.

Chairman SPRATT. Mr. Cooper.

Mr. COOPER. Thank you, Mr. Chairman.

And thank you to the outstanding witness panel.

I would like to highlight Dr. Rivlin's testimony, particularly on page six when she said, "I believe that the stimulus package should be paid for over a 5-year period. The PAYGO principle has never been more important and should be honored. Making exceptions can become a dangerous habit."

I could not agree more. And I would like to suggest that this is actually, although Dr. Rivlin has stated it in the strongest form, a principle I think that all the panelists can agree on. Because at least you are not against PAYGO, at least over a multi-year period.

Dr. Greenstein noted that it would be a mistake to pay for stimulus within the same year. But there is a pregnant pause there. You wouldn't be against paying for it over a 5-year period, I presume.

Mr. GREENSTEIN. I would be very much in favor of that, but I wouldn't want to blow up the stimulus bill over it.

Mr. COOPER. I am not talking about delaying the package. But I would like to suggest, Dr. Greenstein, that if you don't get all your wishes in this package, that you and your center work with Blue Dog Democrats to find a way to pay for, for example, food stamps or other things that might not be in this package, and pay for it over a multi-year period so that it would have a stimulative effect. And I am not talking about a delayed timetable. Perhaps we could get this next package out next month or something. But you shouldn't give up just if you are not included in today's vote.

So I know you are not giving up; that is not your nature. But there are ways to ferret out low-priority Federal spending, to have pay-for plans over a multi-year period that do not worsen our long-term problems. And, like Dr. Rivlin, that is my central fear.

And Dr. Summers has stated it very well, too. He said in his testimony on page four, "Including offsets in a 5- or 10-year window would magnify the impact of fiscal stimulus a little bit by reducing any adverse impact on capital costs because it would avoid any increases in the long-run debt levels." That is my central worry here. When you try to enforce a discipline on a body of 435 people, plus the other body, it is very difficult.

And here we will have honored the PAYGO rule in the breach for the third time. As Dr. Summers pointed out, we had the AMT exception, we had the war cost exception, now we have the stimulus package exception. Pretty soon, people here will forget that we are supposed to do PAYGO at all. And that is deeply worrisome, because the Democratic majority fought for PAYGO very hard last year. We have honored it, but today we will be honoring it apparently in the breach.

The central question, it seems to me, when you talk about longer-term issues, like whether we make the Bush tax cuts permanent, is the percent of GDP that we want our tax revenues to be. It is my understanding that while they dipped down to almost Eisenhower levels, about 15 or 16 percent of GDP for a while there, they are now back up at about 18-plus percent. And that has been, as I recall, a 40- or 50-year bipartisan consensus, that tax revenues as a percent of GDP would be at about that level.

Am I mistaking this, that it would be a substantial change in policy if we were to take tax revenues up to 21, 22, 23 percent of GDP? Wouldn't that be a marked departure from past practice? Dr. Rivlin?

Ms. RIVLIN. Yes, it would. We have had—I think the long-term average has been about 18.5. And every time that revenues have gotten above 20 we have had a tax cut.

But this comes back to a point I made earlier. We now have promises made under entitlement programs that are law that will take spending up to levels that we have not seen ever as a percent of GDP—25, 28, you name it—over time. And unless we rein in those spending levels, we open up a gap between revenues and spending that cannot be financed and that will damage our economy severely.

Mr. GREENSTEIN. Could I add to that? In those periods where revenues were, like in the latter part of the previous decade, in the 20 to 21 percent of GDP range, they did not cause some kind of serious damage to the economy.

But the larger issue is the one that Alice just mentioned. If you look at the changes you would have to make to Social Security and Medicare to keep revenues over the long term at 18.5 percent of GDP without running crushing deficits that would ultimately cripple the economy, you would be looking at changes in Social Security and Medicare that I don't believe any party or any administration could pass. We're going to have to make tough decisions on both the health-care side in particular and the revenue side.

And I think if we do end up making a decision to keep revenues at 18.5 percent of GDP for the next 40 or 50 years, I think that would be a decision to run deficits that would have crushing long-term effects on economic growth because they would be so huge.

Mr. COOPER. The sooner we make these decisions, the better.

I see that my time has expired. Thank you, Mr. Chairman.

Chairman SPRATT. Before you establish 18.5 percent as the normative level, keep in mind, during most of those years, the vast majority of those years, that 18.5 percent of revenues we were running a budget deficit also, so we weren't fully funding the Government with the revenue take.

Mr. Becerra.

Mr. BECERRA. Mr. Chairman, thank you very much.

And to our witnesses, thank you for your testimony.

Let me begin by asking each of the panelists if they can give me a quick response to the following question. If the Senate were able to add temporary increases to unemployment benefits and food stamps without delaying enactment of a stimulus package—you went through that discussion of how soon you would have to see a stimulus package—would that be a good idea, and would you support that?

Two quick questions. Would that be a good idea if you could do unemployment and food stamps without delaying the enactment of a stimulus package? And would you support that?

Mr. GREENSTEIN. Obviously, from my comments here, my answers would be yes and yes.

Ms. RIVLIN. Yes, I would.

Mr. SUMMERS. Yes.

Mr. WESBURY. No.

Mr. BECERRA. I appreciate your quick response to that.

Mr. Wesbury, let me ask you some questions. I agree with a lot of your analytical trajectory, but I also agree with some of what Secretary Summers was saying, that we can't always predict that trajectory that well. And so, much of this is a very academic discussion because we don't know what things will look like tomorrow, let alone 10 or 15 years from now. But we are concerned enough that we want to try to stabilize things.

And I think every time I talk to folks who work within the markets, they always talk about how important stability is. Even if it is something you don't like, so long as you could predict it, at least you could take it into account in making your decision. So stability, predictability, I am told, very important.

So Congress, if you are going to do something that we don't like, so as long as we know that we could predict that it is going to happen, we could factor it into the market's movement. Is that a pretty fair assessment of how the market operates, to some rough degree?

Mr. WESBURY. Yes. And it pleases me that I can say yes to that. Congressman, you have hit on something I think that is real important. Let me kind of step back just a second.

Mr. BECERRA. But very briefly.

Mr. WESBURY. I will do it very briefly.

We live in a time of massive transformation toward an intellectually based technology, and the only time period in history that looks anything like this is the industrial revolution. And that is when we were moving from an agrarian, farm-based economy to a city, manufacturing-based economy. And people didn't like it. It was not fun to have to move from your farm and take your family and move it to the city. And a lot of that kind of transformation is happening today. We need fewer people in manufacturing because our productivity is booming and technology is changing.

Mr. BECERRA. I think a lot of people would agree with that particular assertion. The difficulty, I think, for a lot of folks is that we are not yet seeing this government, this economy, address the concerns of those who might not be winners in that transformation.

Let me ask you a question. We have talked about the Bush tax cuts of 2001 and 2003. And a decision was made by the then-Republican majority in this Congress and the President to make these tax cuts temporary.

Mr. RYAN. Will the gentleman yield on that point?

Mr. BECERRA. If I may finish the question. If I have time, I certainly will yield.

So the decision was made by Republicans in control of the Congress and the President in the White House to make the tax cuts temporary, knowing they would expire, there was a cliff.

Mr. WESBURY. Right.

Mr. BECERRA. Was that good or bad for the markets to know that these were temporary? Was that predictable and stable?

Mr. WESBURY. Right. Well, I can't speak for the markets, but let me put it this way. One of the reasons that was done was because of budget rules, so you have to fit in certain windows, and the market understands that. And so my argument at the time was, if you were in the third inning of a baseball game——

Mr. BECERRA. Well, but let me stop you for a second. In 2003 we passed tax cuts that were set to expire well before 10 years were to go through the budget window. There were some tax cuts that weren't set to take place until well beyond the 2003 date or 2001 date when they were passed. So this wasn't solely a budgetary issue. There were some definitive actions taken, decisions made to let these tax cuts expire.

And so, if predictability and stability are so important, I have a tough time with these tax cuts, understanding is it going to disrupt the markets because they are going to all of a sudden expire? Or did the markets, knowing that they were going to expire because that is the political decision that was made by the Republican majority and the White House, lead to that, and so therefore that drop-off, that change in the tax code was already factored into the markets?

Mr. WESBURY. Congressman, I haven't done this work in a long time, but I did it at one point. And that is that, on average, in the past 50 years, the capital gains tax rate has changed every 3 years. We in the markets understand this. At the time of the passage of that tax cut I argued this, that if in the middle of a baseball game all of a sudden the umpire stopped the game and said, "From now on, a homerun is worth three instead of just one," I believe the baseball players would start swinging for the fences, and their manager would let them. But they were also told that this would end in the seventh inning. When that came around, they would change their behavior and go back to the way that they were. As you come closer to that seventh inning,all of a sudden you begin to sense that it is coming, that change is coming. So as we get closer to 2011, more people start to worry about it, are they going to be extended or not? Also——

Mr. BECERRA. I think you gave me an answer.

And I know, Mr. Chairman, my time is expired, so I will just conclude with this. I wish we had more time to get into this.

I would use the analogy of a child more than a baseball player. You give a child candy during dinner and you tell the child you only get so much candy and for so much time, the child will enjoy getting that candy. When the date of expiration of being able to have candy at dinner is upon that child, the child is going to complain because you gave that child candy during dinner. And everyone wants to be able to continue eating candy. But you can't always have candy because it is not always the best thing for you.

I get the sense that, from what you have said, that markets have, to some degree, factored in what the Republican majority in Congress, what the President did in 2001 and 2003, to have these things expire. So I doubt that there will be this massive disruption in the markets. I do agree, though, that you do begin to build in this confidence that those tax cuts will remain in place. The difficulty is there is a price for eating candy all the time.

My final comment, if I can very quickly, is I have a problem, Mr. Wesbury, when you said a moment ago in your comments about the economy and how it is not moving necessarily as well as you would like but it is moving sportingly along, where you said the economy is literally at full employment today.

For the 7.5 million Americans who are not employed, for the 1.3 million Americans who have been unemployed for more than 26 weeks, for the other, I believe, millions of Americans who are underemployed, meaning not full-time work, this is not full employment. And I really cringe when I hear people say that 5 percent unemployment in a country of 300 million is literally full employment. And I would hope that economists would understand that that is why you get as bad a name as politicians, because you disregard what Main Street is suffering when you speak only from Wall Street's perspective.

And I yield back, Mr. Chairman.

Chairman SPRATT. Dr. Summers.

Mr. SUMMERS. Congressman Becerra, I got lost in some of the analogies. When I take my kids to the ballgames, they eat too much, and they want to keep eating even after the ballgame is over.

I think Mr. Greenstein set here an admirable example for us all. He is a passionate defender of more food stamps, and yet he made very clear that he would oppose extension here, and I think all of us—I think particularly egregiously the Bush administration—but I think, if we're honest, all of us have been known to be tempted by enacting for a temporary period our preferred programs in the hope and sometimes even in the expectations that they will be made permanent, and I think we would have better and more rational budgeting in this country if things that were intended to be permanent were labeled as permanent, advocated as permanent and scored as permanent, and, of things that were described as temporary, even the proponents were prepared to commit to argue that they would not extend. And I think the Bush tax cuts are a particularly strong example of that with the potential for instability of the kind you describe, but I think, in all honesty, Congressman, it would be probably a mistake to suppose that either party had a complete monopoly on virtue in this area.

Ms. RIVLIN. Could I make two quick points?

Chairman SPRATT. Sure.

Ms. RIVLIN. One is a question of what are we stabilizing. I don't think it is the financial market. It shouldn't be. It is the economy as it affects real people. That is the objective of the stimulus package, and secondly, why did the Congress make those tax cuts temporary? Because of the PAYGO principle and because of the realization that, in the long run we would have to face up to can we afford those tax cuts in the light of the spending promises we have made. So the Congress was trying to force itself to say we have got to rethink this when we get to that point, and I think you do.

Chairman SPRATT. Thank you.

Mr. Garrett.

Mr. GARRETT. Thank you, Mr. Chairman.

With all the reference to childlike behavior, maybe it is an appropriate place—here we are in Congress—in light of how sometimes Congress is portrayed as spending other people's money in a childlike manner.

Before I begin, let me refer to the Ranking Member. I think he wanted to make just a comment with regard to the rules and procedures as to why our tax cuts are——

Mr. RYAN. Yeah, I am not interested in invoking another nonsecular analogy.

Just for historical accuracy here, a number of us served on the Ways and Means Committee when these tax laws were written. These 2001/2003 tax cuts were never designed to be temporary. When they left the Ways and Means Committee, when they left the House, they were permanent. Then because of the Byrd rule, a rule in the Senate that applies only to the Senate, they were required to be temporary with the sunset. It was our intention, the Republicans' intention, to make them permanent, but we didn't have the 60 votes needed to do that. We had 55. Because we didn't have the votes to keep them permanent, they were made temporary.

That was never our design, never an intention. It was a result of the fact that there were not enough—I am not trying to be partisan here—Democrats to make them permanent, and we wanted to have the tax relief because of the economic problems confronting us. Always designed to be permanent. But for the Byrd rule, they were not.

Thank you. I yield.

Mr. GARRETT. And I have to say that, when it comes to any new spending program, whether you label it a temporary program or a permanent program, I cannot think in my time here, which is 5 years, of any program that has begun or—nor can I think of any program that I have been involved with during this period of time that existed prior to coming in here, even though they were labeled as temporary, that anyone really felt that they were temporary.

I mean, the one that comes to mind right here—I serve also on the Financial Services Committee. We established a 2-year temporary program called TRIA to deal with a situation there as far as the insurance matter. We just extended it now basically for another 7 years on top of the 7 years, so our temporary program is now going to be on—will effectively be on the books for potentially 14 years, and no one guesses that after those 14 years it is going to be the end. So, whenever we talk about temporary, we have a—it is a misnomer.

Likewise, earlier in the testimony—I apologize. I had to step out—there was some reference to the PAYGO rules and what have you, and I think some of the answers address that in suggesting that we can—I will use the phrase "kick that can down the road" as far as dealing with it. I don't know whether that is the appropriate strategy. I mean, if you are going to have PAYGO rules apply—and I think they should when it comes to spending plans, but not necessarily with regard to tax plans—then you need to bite the bullet, if you will, and deal with them today because, just as with the temporary programs, you never get to the day when you actually end that program. Likewise, if you kick this ball down the road for 5 years, we are never going to get to that fifth year to actually address that PAYGO rule. So that is my first question, and I will leave it to you to answer it.

Secondly, when I came in, there was the issue of consistency, and I think the Ranking Member was addressing this as well earlier on in the testimony. The benefit, I understand, as far as the stimulus package with regard to the rebates and what have you is to do one of three things: stimulate the economy so people will go out and buy things, stimulate the economy by putting it into banks, stimulate the economy by paying some of their bills off.

Everyone that I have talked to in the financial service sector says that this is going to have a de minimis impact; 3 or $600 in buying things is going to be de minimis. The paying off of the bills will be a one-shot infusion into the banks, so to speak, as you pay off your credit cards, but the banks are looking for that consistency as well because they know this is only going to happen in August, and after August, you have paid your bill, but you are not going to be able to do it again in September. They are not going to be able to change their lending practices to say that we are going to ease up on the credit market at this point, which is what we are looking for, as liquidity out there to get the investors off the sidelines and the like.

So my question to you is: Does that really do what we are hoping it will do in those three factors—liquidity, easing up the credit market?

And my final one is, maybe, a little bit off skew here, but I will look to your opinion on this. There is a whole other range that is over here as far as a problem, and that is in the financial service sector, and that is the so-called "side bets on the side bets" with regard to the subprime area. And you have the problems with ANBEC and BIA and others in the bonding areas that are insuring this, and I have heard up to $43 trillion worth of side bets that can be effectively just thrown overboard with regard to the subprime market and how that may play into here, which all of this means what we do here is just going to have de minimis or no impact whatsoever on that.

So I throw it out to all of you on those three points.

Mr. GREENSTEIN. Let me take a tackle of the first of your issues on the temporary question and then leave the others for other panelists.

Mr. GARRETT. Okay.

Mr. GREENSTEIN. Obviously, in areas like what we call the "tax extenders," they never seem to die. They are done on a 1- or 2-year basis. They are always extended.

Having said that, there really is a counterexample to what you have mentioned. If you look at the stimulus package that Congress enacted—the two stimulus packages that Congress enacted on a bipartisan basis in the last recession and the President signed, everything in them was temporary and ended. So, additional weeks of unemployment insurance benefits, we have done those in every recession for the last 40 or 50 years. In every recession they ended, and they ended after the last one.

The bonus depreciation tax cut, which is also in your current stimulus package, we did that in 2002. Some of us were worried it would become a new extender and become a permanent tax cut. It didn't, it ended.

And there was temporary fiscal relief for State governments, and a number of Members were concerned that that would go on forever, and it didn't. It expired on schedule.

So, at least with regard to stimulus packages in recessions, Congress actually has a decent track record of having things that are temporary expire.

On the other hand, once you get outside of stimulus packages in recessions, the record, as you indicated, is not so good.

Mr. GARRETT. Thank you.

Chairman SPRATT. Mr. Doggett. Oh.

Mr. GARRETT. They were going to answer to——

Chairman SPRATT. I beg your pardon. Go ahead.

Ms. RIVLIN. I agree with that, but let me take the PAYGO question.

I was a veteran of the Clinton budget years. PAYGO made an enormous difference and made a great contribution to the fact that we were able to reach surplus on both sides. I have explained to President Clinton umpteen times "that is a very good idea, sir, but we can't afford it," and it was also true of the so-called "middle-class tax cut," which you may remember he campaigned on, but we never did. The way we contained budget deficits was sticking by the rules, and I think the rules have to apply to both sides.

Mr. SUMMERS. Congressman, I agree in spirit with your emphasis that an important part of the situation the national economy is confronting goes to the challenges in the financial markets and, in particular, the challenges in the financial markets associated with securitization and its relationship to the derivatives that you are referring to when you use the phrase "side bets." And I will submit for the record a couple of columns I have written in the Financial Times that give recommendations with respect to some of these—some of these issues.

I would emphasize that I think that is a consideration that militates in favor of something like the bill the House is likely to pass today because the risks of disruption and carnage in the sector that you refer to will be much greater if the economy weakens, because inevitably, if the economy weakens, there will be more people unable to pay debts, which will give rise to more of the problems that you are speaking of. And so acting to prevent the economy from weakening is, I believe, more important because of the financial difficulties that you cite.

I also believe that, because of the financial difficulties that you cite, there is more than the usual uncertainty about the impact that monetary policy will have in stimulating the economy, and that makes a case for a balanced approach to stimulus that uses fiscal policy as well.

Mr. WESBURY. Congressman, I would just add to that comment.

We have heard about, today and in recent months, the history of Japan and about the Great Depression. We have talked about both of those today and the potential of these side bets, as you refer to them, side bets on side bets—and you are absolutely right—with the derivatives market to lead to something like that.

My belief is that you only end up in situations like Japan or in the Great Depression when monetary policy is extremely tight. For example, in Japan, the stock market crash started in early 1990 and fell dramatically, but the Central Bank of Japan was still raising interest rates throughout 1990, and it took them 3 years to cut interest rates back to levels that existed before the crash.

Our central bank today has cut interest rates immediately. In the Great Depression, the money supply fell by 25 percent. The Federal Reserve was raising interest rates in the late 1920s. That is what caused the bank failures and the deflation of the 1930s.

So the belief that somehow these derivatives products can spread to take down the economy, my belief is—is that that only happens in a time of very tight money, and we do not have that today; we have very loose monetary policy, and you can tell that in the fact that gold has almost quadrupled in the past 5 years, and the value of the dollar has fallen by about 50 percent. Both of those indicate that monetary policy is loose today, not tight, which tells me that there is a very small likelihood that the credit market problems will spread to take down other areas of the economy outside of housing.

Mr. GARRETT. And weren't you also talking about a problem of fiat money, us printing too much money now?

Mr. WESBURY. Well, we have a fiat monetary system in the United States, and we have printed too much money, and you can see that because the value of the dollar has fallen. The price of gold is up. The way I described it with the dollar is when you have a bumper crop of corn, the price of corn goes down. When you have a bumper crop of dollars, the value of the dollar goes down, and that is exactly why the dollar has fallen versus the euro. It has fallen versus the yen. It has fallen even versus the Albanian lek.

Chairman SPRATT. Mr. Doggett.

Mr. DOGGETT. Thank you, Mr. Chairman, and thank you for your testimony.

Dr. Summers, at a time when the Bush administration was still whistling "don't worry; be happy," you recognized the dangers associated with this economic downturn, and I think we are among the first people to get out in front and propose a specific solution. You reiterate that approach in your written testimony, and your stimulus was in the range of $50 to $75 billion, and you say you think that is the appropriate magnitude in your written testimony this morning.

I asked Chairman Bernanke, when he was here last week, how much stimulus was too much stimulus, and he suggested $150 billion, was about the level of double-triple what you had recommended, and it was necessary to agree to that level to get bipartisan support for this.

My question to you is pretty much the same. Suppose that, with so many good ideas and not so good ideas out there and so many groups that are eager to avoid PAYGO requirements to get in on this proposal, we quintriple or quadruple or triple what you have and head on up over $200 billion of borrowed stimulus. Will that be helpful, or should we be focusing more on the range of $50 to $150 billion?

Mr. SUMMERS. I have just reread my paragraph under question 4. How large should a stimulus package be?

I think the paragraph probably will not allay the concerns of those who think economists don't write very clearly, but I think, if you read it clearly, you will see that I am advocating—express at one point, given the deterioration in the economy that has taken place in recent months, a package with a total cost of 1 percent of GNP, which corresponds to about $140 billion, would run very little danger of overheating the economy on any plausible scenario. So I am comfortable in the 150 range.

On current facts, I would be uncomfortable if we went far above that, because I think there would be the kind—I think, at that point, the risks that Mr. Wesbury describes if we are talking about a $250- or a $300-billion package would, I think, start to be quite—start to be quite significant.

I would add a technical nuance that, if somebody wants me to, I can explain in detail, but I believe that, for the purpose of judging the stimulative impact of the package, it is probably better not to look at the first-year number, but to look at the 10-year cost of the program, because businesses, in calculating the value of the depreciation allowances, are very much aware that the extra depreciation allowances they are going to get in 2008 are going to be given back subsequently.

So I believe that, for the purpose of analyzing the economic impact of the stimulus package, it is probably better to think of this as being a stimulus package in the $105-, $110-billion range than in the $140-, $150-billion range.

Mr. DOGGETT. Let me ask you one other thing.

Your work is appropriately focused, as, I think, ours must, on finding a bipartisan solution to this downturn, but isn't it important also to note that it did not have a bipartisan cause; that while the business cycle is real, this particular problem grew out of the notion that markets could solve any problem with reference to subprime housing loans, and had it not been for excesses, an attitude that there was no need for any regulation at all of overzealous lending and you could lend to anybody whether they had a good lending record or not—had it not been for those excesses, we wouldn't need any stimulus today, would we?

Mr. SUMMERS. Congressman, I think I may use somewhat different words——

Mr. DOGGETT. I hope they are brief words because my time is running out.

Mr. SUMMERS [continuing]. Than you used.

I think there certainly were important regulatory failures that have exacerbated the difficulties that we have faced.

Mr. DOGGETT. I will settle for that. And let me ask you one other question.

The idea is to get the most cost-effective stimulus. What do you think about taking the cap off and extending the tax rebate to the folks that drew $180,000 average bonus on Wall Street last year instead of focusing it on the people around the median income in our country at $49,000 a year? Should we extend the tax rebates and give it to the people that contributed to this failure and to anyone else, whether they contributed or not, regardless of how much money they earn?

Mr. SUMMERS. I thought Mr. Greenstein gave a precisely accurate answer when he noted that the Senate reduced the size of the rebate from $600 to $500 and did three things with it. One of those things was to remove the caps, and I think he regarded removing the caps as being contrary to the objective of providing stimulus because it wouldn't be spent, and I share his view. He also emphasized, as I had not previously, that the other changes which went in the direction of providing more rebates to children in certain circumstances were favorable for stimulus, and I agree precisely with what he said.

Mr. DOGGETT. Just one last one to Dr. Rivlin.

I believe you made this clear, but we have had a wide range of economists come and testify to this committee, ranging from Marty Feldstein to Dr. Peter Orszag, who was here last week. Every single one of them has said that you could have effective stimulus this year and still comply with the PAYGO rules over a 5-year period. Indeed, Dr. Orszag said you could even have a greater stimulus effect by complying with PAYGO.

Do you agree with that, and do you agree with that, Dr. Summers?

Ms. RIVLIN. I do agree with it.

Mr. SUMMERS. I do agree with that as long as complying with PAYGO didn't mean delay so that you didn't have the stimulus package, which I think it would. So I am comfortable on grounds of avoiding delay with the decision that Congress made. If the Congress had found a way to agree quickly on measures within PAYGO, then I believe stimulus would have been even more effective.

Mr. DOGGETT. And I gather, by your nodding head, that you agree, too, Mr. Greenstein?

Mr. GREENSTEIN. I do, and—because it clearly is not politically possible to move quickly and pay for the stimulus package. What that does is underscore the absolute critical importance of the temporary nature. The long-term effects on deficits are very small if everything here is temporary. It will be very important to ensure everything is temporary, and, if the economy recovers, then everything expires on schedule.

Mr. DOGGETT. Thank you.

Chairman SPRATT. Mr. Blumenauer.

Mr. BLUMENAUER. Thank you, Mr. Chairman.

I actually have enjoyed sort of getting some of the back and forth here. I am a little troubled with the oversimplification that some are suggesting that, a few weeks ago, we were worried that people weren't saving enough money and borrowing too much, and now we are changing all those signals, saying that we want them to spend and borrow more.

I think it is quite clear that we are talking about a long-term, substantial policy change to strengthen investment and savings versus a short-term stimulus, and I would hope that people in Congress would be able to keep those two concepts in mind. They are not inconsistent at all. It is like driving to the store, but occasionally you have to turn right or turn left to get someplace that is straight ahead. And I, too, am prepared, I think, to support not quite as enthusiastically as I would if some of the provisions that—at least three of the four of you had talked about were in it. I would like it to be consistent with PAYGO in the shorter term rather than the longer term, and I would like to put it in the hands of people who need it more. I guess I am one of those people that is deeply troubled by the long-term economic picture.

Dr. Summers, I think you referenced the fact that this cratering out is centered on people's homeownership that is going to have ripple effects in ways that we haven't seen, arguably, since the Depression in terms of the drop in home values, the impact that that has on individuals' behaviors, the actual credit access they get to, and problems that are going to be subjected to them, and State and local finance that goes beyond just 4 percent of the economy that is involved with home construction. I am deeply troubled by how this is going to unwind, which makes me, I guess, even more concerned about Mr. Doggett's regulatory framework and what is going to happen with the long-term investment and infrastructure in this country, and both of you referenced it is not really a short-term fix, but it speaks to long-term economic health.

I would like you to help me think through a couple of aspects of that. We are going to watch the unwinding of a multibillion-dollar wind energy business because of the wind energy production tax credit, which Congress in all likelihood will extend before the end of the year, but people are not going to be betting hundreds of millions of dollars on investments right now for projects and equipment, so we are seeing—it has started to go down. All three times that this has expired in the past, the industry tanks.

Also, we are looking for the first time in our history at a deficit in the Highway Trust Fund, which has no borrowing authority, which is going to result in a pretty dramatic scaling back of transportation investments, probably a 4-to-1 ratio, because of the low spend-out rate. So Congress, in all likelihood, is going to act within the year on both of these areas, but not before there is some negative consequence for the economy.

I am wondering if you think that these admittedly specific infrastructure items that are a little hard to quantify don't have some part of our decision-making in terms of either now or what is going to happen. We will be doing more for economic stimulus, I am convinced, before this Congress is out.

How do I think about things like this that are going to start having a negative consequence, in some cases already are?

Ms. RIVLIN. I think you think about them as unfortunate and try to fix them, and they just speak to the general point that the Congress should be making decisions about big, important things like infrastructure on a much more—on a long-term basis. And it isn't just infrastructure, it is the entitlement programs. It is everything. You aren't at the moment thinking hard about what is the total stuff that we want to fund here, and how are we going to pay for it, and these are just a couple of examples.

Mr. BLUMENAUER. But is this just part of the big averaging of the economy, that we shouldn't be worrying about pulling out a couple of things like this in the context of stimulating the economy?

Ms. RIVLIN. I don't know how big those two particular things are, but I wouldn't mix up this longer-run stability question, which is really important, with the short-run stimulus.

Mr. SUMMERS. Congressman, I share the concern in both areas, but I think an effort to combine it with the economic stimulus issue would—as legitimate as your issues are, I think they are by no means unique. And there will be many, many people with legitimate issues, and an effort to bundle them all into stimulus would, I think, make the prospect of agreement quickly very unlikely.

I would just say on infrastructure that—and I am not by any means an expert on the infrastructure issue—that as important as I think it is, I think there is ample reason to believe that the Congress has not always in the past been as effective in choosing the infrastructure projects that will have the highest rate of return for the national economy relative to the projects that will respond to a variety of constituency interests as at least we economists would prefer. And I think the degree of enthusiasm that could be generated across a wide coalition for increased infrastructure investment would be substantially increased if there was a sense that there were mechanisms in place that would assure that the projects were going to be selected for maximum economic efficiency.

Mr. BLUMENAUER. No quarrel there.

And, Mr. Chairman, I have appreciated your courtesy in times past for our being able to start approaching some of the infrastructure discussion of what some of the longer-term solutions will be. I was just trying to get a sense of what short-term applications we need. I do appreciate your admonition, and I think that is in the ultimate scheme of things. I hope we can get there.

Thank you, sir.

Chairman SPRATT. Mr. Etheridge.

Mr. ETHERIDGE. Thank you, Mr. Chairman, and let me thank you, as others have, for this hearing and for our panelists, for your time and your generosity.

Let me ask the first question, Dr. Summers, to you, because I want to try to be generous to my colleagues who are waiting for their time and try to stick within mine.

I am very pleased, as are my colleagues, that we now have a bipartisan package, but we may disagree, and I happen to disagree with some of the pieces—we would like to see more. But the point I want to ask you is that, on one specific piece in it, I am hearing from my Governor and others are hearing from their Governors as relates to the piece, as relates to the bonus depreciation, how that affects some State government revenues, and my question to you would be—it was a top priority of some folks involved, but can you speak to this aspect in the package as well as any opportunities that it might happen to address as it moves along, if we can, to hopefully reduce the impact on the States as you have talked about earlier?

Mr. SUMMERS. As I understand it, Congressman Etheridge, the impact on States is strictly proportional to what happens to the Federal Government——

Mr. ETHERIDGE. Correct.

Mr. SUMMERS [continuing]. Because of Federal piggybacking.

If the Congress were to adopt my suggestion that the bonus depreciation be applied only to incremental investment above some benchmark, that would plausibly reduce the cost on the order of two-thirds, and that would, therefore, reduce the burden on State governments on the order of two-thirds. And so I think the correct response, if that is seen as a serious problem, is to make the bonus depreciation provision an incremental provision which still gets all the benefit in terms of the investment decision that somebody is trying to work out a strategy with respect to.

Now, many people will tell you that it is enormously complex to have incremental and so forth. I would only make two points. One, we do it successfully with respect to research and development, which is probably, if anything, harder to measure than physical investment; and second, I would suggest, as I have to others in the past on this issue, that a country that can put a man on the moon could probably figure out how to design an incremental investment incentive.

Mr. ETHERIDGE. I agree. Thank you.

Dr. Rivlin, a quick question. You have just talked on infrastructure. Let me just add a point to that, and you may or may not want to comment on it, because I do think, on the whole issue, Congress needs to find a way to work not just individually, but with State governments across the range of all of those infrastructure needs from water, sewer, airports, transportation. And I happen to believe that schools are an important part of this infrastructure. If we truly believe that our future is tied to education, we have got places in this country where they can't meet it, and it seems to me we ought to find a way to put together a package and, maybe, a group of people that could sit down and work it across the timeline, to do a long-range look at it.

I would be just interested in a very brief comment on that so I get one more question in.

Ms. RIVLIN. I would agree with that, and there are the right people—I don't think they are on this panel—to sit down and help you with that.

Mr. ETHERIDGE. I agree. Thank you, ma'am.

Mr. Wesbury, let me ask you a question, if I may, in closing. I don't mean to skip you. I agree with what you said. My point gets back to something. I have been sitting here listening today as we talk about the economic downturn, and we are now in the potential of a recession. All of a sudden, I am scratching my head and remembering 2001, and that is where we got into the tax cuts where we have been arguing whether permanent, temporary. It doesn't make any difference. The long term means we did it based on we were having an economic downturn, and we had to help. Well, as I remember, that came about as a result of Enron and Global Crossing and people who had 401(k)s that became 201(k)s. I remember that. I had one. A lot of other people did. So we were helping the markets.

And I guess my question to you is how different was that from the current economic downturn we are now facing? Because at that point, we reduced—the Fed reduced the discount rate, we reduced tax rates, and now we are talking about reducing it to help the middle- and lower-income people to put money back in.

Tell me what the difference is between then and now.

Mr. WESBURY. The biggest difference is that we really were in a recession then, and we aren't in a recession now.

Mr. ETHERIDGE. No, we weren't when we started. We just thought we were getting into it. Then we found out we were in one, and we kept priming the pump.

Mr. WESBURY. It is always—there is always a delay of recognition. So, in other words, the National Bureau of Economic Research, who is the one that labels recessions, did not tell us until December of 2001 or January of 2002 that we actually were in a recession in 2001. In fact, most economists completely missed the recession of 2001. As late as June, when we were already in that recession, there were only 5 of us in The Wall Street Journal survey out of 55 economists that actually had a recession called.

Mr. ETHERIDGE. But my question is what is the difference between then and now, because we are trying to do the same thing now.

Mr. WESBURY. Right.

Mr. ETHERIDGE. You are saying we aren't in one——

Mr. WESBURY. Right.

Mr. ETHERIDGE [continuing]. And we aren't going to have one.

Mr. WESBURY. Yeah, I would—my models in 2000 said we were going to have a recession in 2001. We did. My models—these very same models that caused—that called that recession are saying we have about a 10 percent chance of recession right now. Today we have got durable goods orders. They were much better than expected. Initial unemployment claims are still low. All of the doom and gloom that we have been supposed to see is not showing up.

And so I guess my point is—is that I—at least then we had a clear downturn and a whole bunch of data that led us to that point. This time we don't have a clear downturn. We have a lot of forecasts. We have a lot of fear.

Mr. ETHERIDGE. I expect, if you talked to all these folks who have lost their homes, people who have lost value in it——

Mr. WESBURY. Of course.

Mr. ETHERIDGE [continuing]. And people losing their jobs, they are going to disagree with your model. I hope you are right. I really hope you are right. I pray that you are right, but if you are wrong, then I hope we are right in making some decisions that will soften that blow.

Thank you, Mr. Chairman. I yield back.

Chairman SPRATT. Mr. Scott.

Mr. SCOTT. Thank you, Mr. Chairman.

Let me follow up with that, Mr. Wesbury.

When you say "recession," are you using the normal definition of two consecutive quarters of negative growth?

Mr. WESBURY. That is a rule of thumb that we have, but typically we look at industrial production, consumer spending and unemployment.

Mr. SCOTT. That is the basic definition.

Have there been any months recently where there has been, in fact, a negative growth?

Mr. WESBURY. No.

Mr. SCOTT. And so stringing three together with accumulative negative growth would be, in your view, unlikely?

Mr. WESBURY. I believe so. My odds of recession right now are about 10 percent.

Mr. SCOTT. Okay. Dr. Rivlin, you can have a lot of problems even though you are not technically in a recession. We have seen the median wage go down over the last—over the last 7 years, anemic growth in the Dow and job growth and the record foreclosures. My question on foreclosures is if we—a lot of these people were caught up in the subprime loan debacle. If we were to have a fund where people could refinance in 6 or 7 percent permanent loans, how would that fund be scored?

Ms. RIVLIN. How would it be scored?

Mr. SCOTT. Would you have to score it if——

Ms. RIVLIN. I am not—I am not sure. You would have to call Peter Orszag and talk to him about it. I think it would depend on how you set it up. I don't think it would have major budget impact——

Mr. SCOTT. Okay.

Ms. RIVLIN [continuing]. But I think it is a very good idea. It is a very hard thing to do because of the way the subprime loans have——

Mr. SCOTT. But it is possible that it wouldn't cost that much on a Federal scoring basis.

Ms. RIVLIN. Yes, I think that is possible, but talk to the people who really know.

Mr. SCOTT. As we were talking about the budget, Dr. Summers, you were Treasury Secretary when we built up this surplus. We have heard a lot about these earmarks. The way they work is if you have a $100 million appropriation, you have got an earmark saying out of that 100 million, spend a million dollars on XYZ project. If you eliminate the earmark, you still have the same funding.

Is it true that if you eliminated—if you eliminated all of the earmarks, what effect would that have on the budget deficit?

Mr. SUMMERS. I think earmarks are an issue for the composition of spending. I think it would be a serious mistake to pretend that earmarks are in any way, shape or form the cause of the Federal deficit——

Mr. SCOTT. Well, if you eliminate——

Mr. SUMMERS [continuing]. Or that eliminating earmarks would have a meaningful impact on the country's aggregate fiscal position.

Mr. SCOTT. So eliminating the earmarks would have no effect on the budget because the money would be spent anyway.

Mr. SUMMERS. It would depend on whether the totals under which the earmarks came were adjusted or not, but the argument about earmarks should be an argument about efficiency of spending. It should not be an argument about the overall size of the deficit, and those who blame the deficit on earmarks are misstating the situation.

Mr. SCOTT. Now, in terms of timely, targeted and temporary, we have rebates going up to families making $150,000. Over 40 or $50,000, what is the stimulus effect of the rebates? Is it much less than those rebates that go to the lower half?

Mr. SUMMERS. I think, as best we can tell, that as income levels rise, the rate at which money will be spent declines, so I would expect that money that goes to those with under $50,000 would tend to have a larger impact than money that went to those between 50 and 100, which would be greater than those between 100 or 150. Once you got above 150, I would be surprised if you were looking at much stimulative impact at all.

Mr. SCOTT. Mr. Greenstein, you indicated that the accelerated depreciation would, for every dollar, cost 27 cents worth of economic impact. Is that what I understood?

Mr. GREENSTEIN. Not my estimate.

Mr. SCOTT. Okay.

Mr. GREENSTEIN. This is an estimate by——

Mr. SCOTT. Did that include the fact that you get some—get all the money back in the fullness of time?

Mr. GREENSTEIN. This is an estimate from Mark Zandi, who is the chief economist of Moody's Economy.com. I would need to look more at the precise methodology. I can get back to you with an answer.

Mr. SCOTT. Okay. Now, Dr. Summers, you indicated that, if it had been targeted as incremental, you would get a much better bang for the buck, so that 27-cent figure would be significantly higher if you only had it available for the incremental cost. If it is not the incremental cost, you may be giving tax breaks for what people would be doing anyway, so that portion of it would have no stimulus effect at all; is that right?

Mr. SUMMERS. Correct.

Mr. SCOTT. Dr. Rivlin, you indicated that construction projects were not as good stimulus because it took so long to get them going. If you limited the stimulus spending in the stimulus package to projects ready to go, would your opinion change? That is, if the Governor—if the Governor could commit to the fact that, if you give me this money, we will start laying cement; we have already bought it; we have already designed; it is ready to go; the only barrier is we can't afford the money; if you give us the money, we will start building the road immediately, would that change your mind?

Ms. RIVLIN. It would help, but it wouldn't change my mind about putting construction into this stimulus package, because it runs into all of the arguments about earmarks and other things. And the other problem with construction projects is they tend—people who are employed on construction projects tend to be relatively high-income. It is not as effective a stimulus as, say, putting money into food stamps, ever.

Mr. SCOTT. Since the money, apparently, won't be getting out until the summer anyway, would a summer jobs program for low-income youth get the money into the economy effectively? It would be timely because it would be the summer. It would be temporary because they are summer jobs. And it is obviously targeted at people who pay—who would be spending their paychecks.

Ms. RIVLIN. I think that is a plausible thing to consider, but I wouldn't put it in this package.

Mr. SCOTT. And that is because you don't want to change it because it may disrupt things; is that right?

Ms. RIVLIN. Yes. If you start adding things, there is no end to what you might add.

Mr. SCOTT. Well, if it starts getting changed around, that would be a nice thing to add to a stimulus package.

Mr. SUMMERS. I would also be concerned that an actual summer temporary jobs program of the kind that would be implemented might, in fact, end up paying for a variety of jobs that State and local governments were going to create anyway rather than—I think it would take quite a bit of design to ensure that a program had truly incremental impact on the level of summer job creation, and that would be an aspect that I would worry about with—a separate issue that I would worry about with respect to that proposal.

Mr. SCOTT. Thank you, Mr. Chairman.

Chairman SPRATT. Ms. Kaptur.

Ms. KAPTUR. Thank you, Mr. Chairman, and thank you all for giving us the benefit of your time this morning. You have been very, very generous.

My two questions are: From where will the United States borrow the money to pay for this rebate program—I refuse to call it a "stimulus"—and how many jobs will this rebate program create? Those are the two questions.

While you are thinking about that, I wanted to ask, Mr. Wesbury, could you please tell me who the chief executive officer of First Trust Capital Partners is?

Mr. WESBURY. First Trust Capital Partners is—the chief CEO is Jim Bowen.

Ms. KAPTUR. Jim Bowen.

Mr. WESBURY. Yeah. I am not here, by the way, speaking on behalf of the firm. I am here speaking on my behalf.

Ms. KAPTUR. Okay. And do they invest any sovereign wealth funds?

Mr. WESBURY. No.

Ms. KAPTUR. And their major business is not then with foreign investment——

Mr. WESBURY. Absolutely not.

Ms. KAPTUR [continuing]. Filtering foreign investment into this country? Are private equity funds, to your knowledge, taxed at the same rate as regular corporations, both the executive officer's pay as well as the company itself?

Mr. WESBURY. If the executive officer of a private equity fund receives a salary, it is at the same tax rate as you and I.

Ms. KAPTUR. And what about the corporation itself?

Mr. WESBURY. The corporation income is taxed at the corporate tax rate, yes.

Ms. KAPTUR. All right.

Mr. WESBURY. If there is carried interest, that is a different story.

Ms. KAPTUR. Thank you very much.

I just wanted to state for the record what I said to Chairman Bernanke last week, and that is that I have served in Congress long enough to witness the dismantling of our traditional housing finance system post-World War II, our thrift system, our savings system, and we were told at the time—and I fought it—but we were told that if we moved into securitization and the global markets, that we would not risk any housing downturns; that, in fact, this was going to be all good, and we would never have to suffer what our people are now suffering with the rate of foreclosure and so forth. So something didn't work out in terms of safety and soundness. Either the regulatory process didn't work. Something happened to lead us to the point where we are today.

Before you answer my two questions on where we will get the money to pay for this rebate, and how many jobs will be created, let me just state, for my district today in northern Ohio, what we need are living-wage jobs where wages rise with the rise in productivity that our people are putting forward. We are not getting that. In fact, people are finding their incomes shrinking in terms of real buying power, despite how hard they work. We need lower utility bills. We need lower gas prices. We need an energy-independent America.

I ask myself, does this package lead us in that direction in any way? Our food banks need emergency food. They are running out, and they are oversubscribed, and the people are coming in the doors, and people are literally stretched to the edge. We need more LIHEAP payments. People cannot pay their utility bills in northern Ohio; not all, but growing numbers cannot pay. We need feet on the ground from HUD and from Fannie Mae and Freddie Mac to help our people work out, where we can, their mortgages. The rate of home foreclosure is exploding. I don't see anything in this package that does anything with those.

Congressman Scott talked about a summer program. Our city government is having trouble paying its bills because of rising energy costs and even the costs of garbage trucks running down the road. The cost of the gasoline is so much more that our local governments don't have money for infrastructure to take care of local roads. We need extended unemployment benefits, and, frankly, the State of Ohio loses under the current proposal. Our Governor now—I don't know. They are going to have to—just trying to figure out anywhere from $100 million to $600 million that they don't have at the State level, that somehow the package causes Ohio to even have more trouble that it currently has.

So my questions to you are: From where will we borrow the money to pay for this rebate, and how many jobs will it create?

Mr. SUMMERS. My estimate would be that it will create several hundred thousand jobs. That estimate is derived from an estimate of 1 percent of GNP—1 percent of GNP in stimulus, some multiplier attached to that 1 percent of GNP, and historical relationships between GNP and unemployment would suggest the likelihood that several hundred thousand jobs will be created or will be saved by the package.

Ms. KAPTUR. Dr. Summers, that is what they said to us about NAFTA, that if we passed NAFTA, we would get millions of jobs, and it has been a job drain all over this country. So I am a little—unless you can tell me where the jobs will be—if they are in infrastructure, food production, wherever they are, how do I know where they are?

Mr. SUMMERS. I think one could—I don't have the numbers at my disposal. One could construct estimates of an increase in GNP spurred by increases in consumption, and I think you would find that the jobs were widely dispersed with respect to the economy. I think, in light of the hour, I will resist the urge to debate NAFTA and its merits with you.

As for the financing, the financing will come from the government issuing more debt. Historically that debt is purchased by a wide range of investors, some of whom live within the United States and some of whom are abroad.

Ms. KAPTUR. What percent, sir, of the current debt is purchased by foreign interests in the last fiscal year?

Mr. SUMMERS. It sounds like you know that number. Precisely——

Ms. KAPTUR. Probably 80 percent.

Mr. SUMMERS. You should provide it to us.

Ms. KAPTUR. Eighty percent by foreign interests.

Would anyone else like to comment on where the money will be borrowed from?

Ms. RIVLIN. No. As Professor Summers said, it will be borrowed from the same sources that the U.S. Government always borrows from when it sells Treasury securities.

The one thing I would stress in the answer to how many jobs, it is not job creation we are after here. It is saving jobs that would otherwise disappear on balance. It won't be necessarily the same jobs.

Mr. WESBURY. And I agree that it will be borrowed in the Treasury market. The buyers will be probably the same ratio as typically are that enter into those transactions with the Federal Government.

Ms. KAPTUR. Mr. Wesbury, from what you know of the markets, which countries are likely to purchase those bonds if you look at last year as the trend?

Mr. WESBURY. You know, you probably know that list pretty well.

Ms. KAPTUR. It is China or——

Mr. WESBURY. It is clearly China and Singapore and Japan and OPEC nations, which have a big surplus with us because of oil.

Ms. KAPTUR. The oil-producing countries.

Mr. WESBURY. Sure. Yeah. And we have a global financial system. We buy their debt, by the way, as well. There is investment going both ways, and I believe, by the way, that benefits the world.

But let me address the jobs issue. I do not believe the stimulus package will create any new jobs. From a manufacturing point of view or a retailer's point of view, this is a temporary stimulus. It is designed to do that. Why would I build a new store or expand my manufacturing capabilities to meet demand that will be very short-term in nature? I just won't do it. And because we take the money from somewhere else—that is every dollar we borrow to give to—to rebate is a dollar less in the hands of an investor that could have invested in the United States, and today I believe we need investment, especially with the losses in our financial institutions, and any crimping of those dollars or capital available for investment actually, I believe, does the opposite of what we want it to do today.

Ms. KAPTUR. Mr. Chairman, would you indulge me for one final question?

I wanted to ask Mr. Greenstein: You pointed out that food stamps and unemployment insurance are the most effective stimulus available, which is compelling, but it seems that there are more compelling reasons to provide help to low-income people in a recession.

Can you talk about the hardships that poor families might be facing during a recession and how food stamps and unemployment insurance could help them?

Mr. GREENSTEIN. Well, food stamps and unemployment insurance obviously help people's bottom lines. The issues are not exactly the same.

In the case of food stamps, we are talking about people with very low incomes. In the case of unemployment insurance, some of the people have low incomes. For some of the people, there is still a second earner in the family who is still employed, and they may not be in poverty. They may still be at some moderate income level. But from a stimulus standpoint, if you lose your job, and you get unemployment benefits, and they run out before you can find a new job, then there may be a significant reduction in consumption, and that is what we are trying to avoid in the stimulus package.

We are trying to keep consumption up, because when consumption falls, then the businesses that sell goods and services don't need as many workers because they can't sell as many products, so they lay some of their workers off, and then those people consume less, and you get the spiral.

So I think Professor Summers mentioned this earlier in the hearing. In essence, what you are trying to do in the stimulus package is to prevent that kind of a downward spiral; keep consumer purchasing up so businesses can still sell their products, they don't have to lay off workers, and you don't get this downward spiral, and obviously, we get a double benefit.

We get from a policy standpoint, in my view, given my own views, a double benefit here that the types of measures that are most effective dollar for dollar in keeping consumption up and therefore stimulating the economy are those that also target on the people who are in the most trouble, for the precise reason that, if you are in the most trouble and you have trouble making your bills, you get an additional dollar. Whether it is an unemployment insurance benefit or a tax rebate or whatever, you are going to spend nearly all of it; whereas, if you are really in good shape, and you are high on the income scale, you are likely to bank most of a tax rebate check or whatever you get. So we do have this coincidence that the items that are most effective as stimulus also have the effect of helping the people who are in the most trouble.

I would also note that the unemployment insurance in food stamp provisions tend to have the effect of targeting regions that are in the most trouble. Obviously, if a particular area—a particular set of States has their economy go way down and their unemployment rate go way up, they are going to have a larger percentage increase in the proportion of their labor force that is unemployed and that will benefit from unemployment benefits, and those benefits will be spent in the local economy. Similarly, food stamp caseloads will increase more in parts of the country where the economy is weak than in parts of the country where it stays strong. So you kind of get a natural targeting effect as well in terms of areas of the country.

Ms. KAPTUR. Thank you, Mr. Chairman, very much.

Chairman SPRATT. Mr. Ryan has one final question to ask for clarification.

Mr. RYAN. Well, I know you wanted to hit the gavel at 1:00. I guess I will just do this very quickly.

Mr. Cooper had a line of questioning that was very interesting. I wanted to follow up on it and see if there is a consensus here.

Putting political realities aside, going down in the century, looking at the trend lines, which is—our historic tax slice of GDP is 18.3 over the 40-year number, and I think the 50-year number is 18.1 percent of GDP.

Is it not dangerous for our economy, for our future living standards to pierce that 20 percent level, and given that entitlements are taking us up to, I think, 40 percent of GDP midcentury, 2040—that's the GAO's number—is it better to try and get that expenditure line down to the revenue line at sub 20 percent, or should we just allow the revenue line to go up to that 40 percent GDP expenditure line? And let us just go from left to right, which is your right to left. Curious.

Mr. SUMMERS. I don't think there is any magic level of 20 percent at which danger is—in which danger comes to the economy. I think the entitlements issue, as the tone of your question suggests, is a very serious one, and I suspect that the necessary way to address it will involve reforms on both the expenditure side, as you suggest, and on the revenue side.

Mr. RYAN. My basic question is: Where is that turning point? Is there a turning point, in your mind, at 22 percent of GDP, 24, 30?

Mr. SUMMERS. Clearly as you raise tax burdens, potential inefficiencies associated with taxes rise. Clearly as you fall further and further short of providing healthcare to people of the kind that technology makes available, the losses to the economy from those failed opportunities rise.

There is a balance that has to be struck. It probably has to be struck differently for every generation, and it is the task of our elected leaders to strike that balance. But, I think, thinking in terms of danger points is almost certainly a serious mistake. I would not for a moment recommend it to the United States, but there are a number of countries that have enjoyed economic growth as rapidly as ours and have enjoyed unemployment rates as low or lower than ours who have tax shares of GNP of 30 or 35 or even more percent. I think that would be wrong for the United States, but I think any effort to suggest that there is some danger point over which we head into some abyss of stagnation is extremely misleading.

Mr. RYAN. Dr. Rivlin.

Ms. RIVLIN. I agree with that. I don't think there is a magic number on how much of the GDP you devote to government, but what is magic is that you pay for it over the long run, and we have not been. As the Chairman noted earlier, we have been running deficits in the range of 2 percent of GDP for a long time on the average, but now we are headed into a really dangerous area where, if we don't change course, they go up to 5, 6, 10, whatever. So we just have to decide how much do we want to spend, and how much do we want to tax.

And then the other point I would add to what Professor Summers said is it matters how you tax, and we should be thinking very seriously about reforming our tax system and, I think, putting less reliance on the income tax and more reliance on consumer taxation.

Mr. RYAN. Mr. Greenstein.

Mr. GREENSTEIN. Sir, you kind of asked—you have got these two lines—the spending line and the revenue line. Do you bring one down to the other or the revenue line up to the spending? Neither one is going to be politically feasible or is going to work. We are going to have to both bring the spending line down and bring the revenue line up.

And to build on what Alice just said, it not only matters how you tax, the composition of spending also matters. If you stay at 18½ percent of GDP, and as a result of that we underinvest in education and the infrastructure crumbles, that has significant economic effects.

It seems to me that, if we are talking about the danger area, the danger that underlies all of this is we will not be able to bring those two lines in future decades remotely close to each other unless we have some kind of systemwide healthcare reform, because the single biggest issue here—as I know, Peter Orszag has testified before the committee—are the projected rates of growth in healthcare costs systemwide. It is not something unique to Medicare and Medicaid; it is system-wide rates of healthcare cost growth, and if we don't address those, they not only affect the Federal budget, they affect employers as well in the private economy. So——

Mr. RYAN. Thank you. I think we can agree on that one.

Mr. Wesbury. Final.

Mr. WESBURY. Yes. I agree as well that there is no magic level of government spending that—or government taxation that always precedes a recession. We have had many recessions with tax receipts at 15, 16, 17 percent of GDP.

However, I would suggest that we have had two periods of time where tax receipts went above 20, and in both of those times, we had recessions, the latest being in 2001.

The long-term average—about a 50-year average—of tax receipts is 18.1 percent of GDP. Today we are at 18.4, which is kind of interesting for those people who say lower tax rates don't generate revenues. They are. They are generating, in fact, more than the long-run average of revenues to the Federal Government as a share of GDP.

It is very clear to me, looking throughout history, that rising tax burdens, especially the tax rates—it is not always tax revenues that we should focus on—tax rates inhibit growth.

And then one last point. When Dr. Summers brought up the fact that other countries have operated at 34 or 35 percent tax rates, we have that in the United States. If you add State and local and Federal tax burdens along with the burdens of regulation, we are at a 35 to 40 percent burden on the private sector today, and so we are operating. The problem becomes when we go out into the future. The cost of entitlement programs rises, and if we were to increase tax rates to pay for that, I believe we would harm our economy just like we have done in the past.

Mr. RYAN. Thank you.

Chairman SPRATT. This concludes the hearing. I want to thank our witnesses for coming and for your clear, forthright and very useful answers.

I would ask unanimous consent that any Members who did not have an opportunity, to be able to submit questions for the record within 7 days.

Thank you very much for coming. Thank you very much, indeed.

[Whereupon, at 1:08 p.m., the committee was adjourned.]

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