RSC
Republican Study Committee

Rep. Jim Jordan (R-OH), RSC Chairman
Paul Teller, Executive Director

Budget and Spending Task Force
Weekly Report

Congressman Scott Garrett (R-NJ), Chairman

January 19, 2011

Obamacare Worsens Budget Outlook by $701 Billion

This week, the House is considering legislation (H.R. 2) to repeal "Obamacare." Democrats claim that repealing this law would increase the deficit by $230 billion over ten years. However, to arrive at the real budgetary consequences of H.R. 2, it is necessary to subtract from this figure the following budgetary gimmicks:

$115 billion of un-counted discretionary spending: The legislation, according to CBO, will lead to $115 billion of new discretionary spending. Democrats simply pretend this spending does not exist in their calculations.

$70 billion of borrowed premiums from the CLASS Act: The CLASS Act will cause $70 billion of premiums to come into the federal government in the first ten years. Democrats count the premiums for this law, while ignoring the liabilities that are being racked up in the form of future spending (which falls outside of the budget window). Here is what Democrat Budget Chairman Kent Conrad said about this program: *"A Ponzi scheme [that] Bernie Madoff would have been proud of."*

Double-counting $450 billion of Medicare and Social Security funds: Democrats claim that $398 billion of Medicare cuts, and $52 billion of payroll tax increases, are dedicated to these programs. If that is true, they cannot also claim the savings as reductions to the federal deficit. The money can only be used for one purpose or the other.

Not counting $208 billion of promised "doc fix" spending: The Democrats included this in the original version of the bill, and then dropped it just to change the CBO score. However, their promise to provide the "doc fix" still hangs over the federal budget, and should be considered in the cost of the law.

According to the House Budget Committee, after accounting for the gimmicks described above, H.R. 2 repeals a law that would cause the deficit to increase by $701 billion over ten years.

Quote of the Week:

"In short, there was never any reason to believe that the law reduced the deficit by roughly $140 billion over ten years. Starting two new open-ended entitlements without fixing the existing budgetary cancers just doesn't work that way. For the same reasons, repealing Obamacare is simply a first step toward fiscal sanity that should happen as soon as possible."

-Former CBO Director Douglas

RSC to Introduce "Spending Reduction Act"

This week, the RSC will launch the Spending Reduction Act. The legislation will reduce federal spending by $2.5 trillion over ten years. The legislation would specifically accomplish the following:

FY 2011 CR Amendment/"Stimulus" Repeal: Replaces the spending levels in the FY 2011 CR with non-defense, non-homeland security, non-veterans spending at FY 2008 levels. The legislation further prohibits any FY 2011 funding from being used to carry out any provision of the Democrat government takeover of health care, or to defend the health care law against any lawsuit challenging any provision of the act. **$80 billion savings in FY 2011.** The legislation further repeals the remaining "stimulus" spending, which leads to an additional **$45 billion of savings.**

Discretionary Spending Limit, FY 2012-2021: Eliminates automatic increases for inflation from CBO baseline projections for future discretionary appropriations (based on legislation introduced by Representative Gohmert, H.R. 4408). Further, the proposal imposes discretionary spending limits through 2021 at the 2006 levels on the non-defense portion of the discretionary budget. **$2.29 trillion savings over ten years.** The legislation also includes more than 100 additional spending reduction proposals that combine for savings of **$380 billion over ten years.**

Federal Workforce Reforms: Eliminates automatic pay increases for civilian federal workers for five years**.** Additionally, cut the civilian workforce by a total of 15 percent through attrition. Allow the hiring of only one new worker for every two workers who leave federal employment until the reduction target has been met**.**

For more information, please contact Brad Watson at x69719

THE WALL STREET JOURNAL.

The Market Flashes 'Caution' on U.S. Treasurys

The forward five-year annual inflation rate has increased 94 basis points to 2.90%, which is now above policy makers' unofficial target of 2%.

By NEEL KASHKARI AND STEVE RODOSKY

Many politicians talk about America's large and growing federal debt, but they've taken little corrective action. We know that our political system responds to a crisis, but it would be very costly to Americans to wait for an acute fiscal crisis similar to the one currently facing Europe. Our leaders must act while the U.S. continues to enjoy the benefits of a strong Treasury market.

Policy makers often ask how much time we have before markets lose confidence in Treasurys. No one knows for sure: It could be many years from now, but confidence could also fall rapidly.

Confidence is not determined only by absolute economic strength, but also by relative strength. If our major trading partners improve their fiscal position more quickly than we do, which appears to be happening, investors could change their preferences and invest elsewhere. While an explicit default is in theory possible, it is highly unlikely given that the U.S. can always print more dollars. Investors should be more concerned about losses through dollar devaluation and inflation—an implicit default.

In hindsight, we know that weakening underwriting standards and increasing prices relative to income were early signals of problems in the housing sector. Although we can't specify exactly how much time we have, we can suggest market indicators that leaders should watch for warning signs:

• Increasing U.S. government debt-to-GDP ratio. From 1960 to 2007, that ratio averaged 36%. At the end of 2010, it was 62%. The Congressional Budget Office forecasts that it will climb to 100% by 2020 unless current tax and spending policies change. Research by economists Carmen Reinhart and Ken Rogoff indicates that sovereign debt begins to stifle economies' productive capacity when it passes 90% of GDP. Japan has had a ratio of greater than 150% for several years, and it has contributed to anemic growth.

• Increasing inflation expectations. The U.S. has enjoyed low inflation for two decades due to the Federal Reserve's commitment to stable prices. But if that resolve were perceived to weaken, confidence in Treasurys would decline, pushing both nominal and real yields higher. Since Fed Chairman Ben Bernanke's Jackson Hole speech in August 2010, the forward five-year annual inflation rate has increased 94 basis points to 2.90%, which is now above policy makers' unofficial target of 2%.

• Reduced Treasury demand from abroad. Foreign ownership of Treasurys has increased to 55% in 2008, from 34% in 2000, providing the U.S. with cheap funding. As the U.S. continues to issue record levels of Treasurys, it will grow increasingly difficult for foreign buyers, both private and sovereign, to maintain their share. For example, foreign ownership of Treasurys has fallen to about 50% today. As foreign buyers increasingly look elsewhere, U.S. funding costs could increase, creating a drag on economic growth.

• Rapid dollar depreciation. A large and rapid drop in the value of the dollar would indicate concerns among investors in Treasurys and across the U.S. economy. Although currencies are volatile, the dollar index (DXY) has fallen by 5% or more in one month only 16 times since the index began 44 years ago. It has done so four times in the past two years. This suggests increased concern about the stability of the dollar.

• Dramatic steepening of the yield curve. A steepening yield curve—signifying that long-term rates are climbing more quickly than short-term ones—is usually a positive indicator that reflects increased optimism for future economic growth. However, if the yield curve were to steepen while economic growth expectations remained modest, such as during a period of prolonged private deleveraging, it could indicate that investors were demanding higher rates to compensate them for

increased risk over time. Today's yield curve has 10-year rates about 315 basis points above overnight rates. A spread of greater than 400 basis points would be rare and potentially concerning.

None of these indicators is perfect, but it is important to monitor them because the market is flashing "caution." If investors lose confidence in the U.S., it could take years or decades to be restored.

Mr. Kashkari, managing director and head of new investment initiatives at PIMCO, was assistant secretary of the Treasury under George W. Bush, where he ran the Troubled Asset Relief Program. Mr. Rodosky is managing director and head of U.S. government bond trading at PIMCO.