# United States House of Representatives
# Committee on Financial Services

## Hearings on
## Promoting Economic Recovery and Job Creation:
## The Road Forward
**January 26, 2011**

**Testimony of**
William Poole[1]

Mr. Chairman, members of the Committee, I am William Poole, Senior Fellow, Cato Institute. I was President of the Federal Reserve Bank of St. Louis from 1998 to 2008. As is my custom, I am speaking for myself and my views do not necessarily reflect the views of any of the organizations with which I am or have been affiliated.

I am pleased to be here today to discuss issues with regard to promoting economic recovery. The topic is obviously a huge one; what aspects of federal policy deserve to be at the top of the list of concerns? Because the recovery process may take five years or more to bring the unemployment rate below six percent, it is critical that we examine appropriate policies in a long-term context.

However well the economy may perform this year—four percent GDP growth seems a reasonable projection—growth over an extended period will require that the federal budget be put in order. There must be no higher priority. Jobs created this year at the expense of jobs created in future years will not get us to where we want to go.

Before I get to budget issues, a few brief comments on regulation. There are scores of disquieting anecdotes circulating about the depressing effects of regulation. One that I heard recently concerned a company that had for many years hired summer interns. Not this past summer, however. Following an examination of the effects of the Affordable Care Act in increasing insurance costs and risk, the company decided to forego its usual summer intern program. I find the anecdotes persuasive, but whether regulation adds up to a significant impediment to growth is yet to be determined. To my knowledge, we do not have evidence of sufficient quality to justify publication in a peer-reviewed economics journal to reach a conclusion. We do have our common sense, however; regulatory burden and regulatory uncertainty cannot be helping to speed economic recovery.

### The Federal Budget Issue

The general public does not understand the enormity of the budget challenge. I fear that many members of Congress do not understand the challenge either. The Congressional Budget Office has said clearly that the current budget is not sustainable. It is natural, and often

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appropriate, to view the task of repairing a budget problem as involving some combination of tax increases and spending cuts. It would be useful if Congress would ask the CBO to clarify this issue by projecting the tax rates that would be necessary to finance spending in current policy projected over the next 30 years. What will be immediately apparent, I believe, is that there are no tax rates consistent with the functioning of a market economy that could finance projected spending.

If tax increases cannot fix the budget problem, then Congress will have to cut outlays. Above all, Congress will have to scale back entitlement spending. That means Social Security, Medicare and Medicaid. I will be blunt: we cannot save Medicare in its current form.

Note that I said that the issue is spending in current *policy*, not spending in current *law*. As the CBO emphasizes in its very important study, *Long-Term Budget Outlook*, released this past August, the Administration and Congress have quite systematically set current law to understate likely outlays and overstate likely revenues. That is a problem with the current Administration and is how the Nation ended up with Bush Administration tax cuts that expired at the end of 2010. Here I will be blunt again: current law budget projections for future years have become so distorted that they are hardly worth looking at.

The problem of inaccurate and distorted budget projections is especially acute with regard to Medicare. The chief actuary said this in the appendix to the Medicare Trustees Report released August 2010.

> In past reports, and again this year, the Board of Trustees has emphasized the strong likelihood that actual Part B expenditures, [which are those for physician services], will exceed the projections under current law due to further legislative action to avoid substantial reductions in the Medicare physician fee schedule. While the Part B projections in this report are reasonable in their portrayal of future costs under current law, *they are not reasonable as an indication of actual future costs. Current law would require physician fee reductions totaling an estimated 30 percent over the next 3 years—an implausible result.* [Emphasis added]
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> Further, while the Patient Protection and Affordable Care Act, as amended, makes important changes to the Medicare program and substantially improves its financial outlook, there is a strong likelihood that certain of these changes will not be viable in the long range. …
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> Without major changes in health care delivery systems, the prices paid by Medicare for health services are very likely to fall increasingly short of the costs of providing these services. By the end of the long-range projection period, Medicare prices for hospital, skilled nursing facility, home health, hospice, ambulatory surgical center, diagnostic laboratory, and many other services would be less than half of their level under the prior law. Medicare prices would be considerably below the current relative level of Medicaid prices, which have already led to access problems for Medicaid enrollees, and far below the levels paid by private health insurance. Well before that point, Congress would have to intervene to prevent the withdrawal of providers from the Medicare market and the severe problems with beneficiary access to care that would result. Overriding the productivity adjustments, as Congress has done repeatedly in the case of physician payment rates, would lead to far higher costs for Medicare in the long range than those projected under current law.

> For these reasons, the financial projections shown in this report for Medicare do not represent a reasonable expectation for actual program operations in either the short range (as a result of the unsustainable reductions in physician payment rates) or the long range (because of the strong likelihood that the statutory reductions in price updates for most categories of Medicare provider services will not be viable).

A U.S. federal budget crisis is improbable this year. However, without action to stabilize federal finances, a crisis will eventually occur, although its timing is impossible to predict. Consider the sovereign debt situation in Europe, which seemed relatively benign in mid 2009. Then, Greece blew up and Europe's credit markets have been in turmoil ever since. Could such a situation arise here? Yes.

Everyone agrees that tough decisions are needed, but many say "not yet" because of the importance of nurturing the recovery. I doubt that federal spending is as important to the recovery as many believe, but suppose I accept the argument that Congress should go slow in cutting spending. Many things could and should be done now that would have a minor effect on current spending but a major long-run effect. The report, issued this past December, of the President's Deficit Commission (officially, National Commission on Fiscal Responsibility and Reform) contains many useful recommendations. Modifying Social Security to place the program on a sound basis need not involve any changes to current benefits or taxes; following the Commission's recommendation would demonstrate that the federal government can get serious about fixing the budget problem. Another good candidate, in my view, would be to phase out ethanol subsidies.

There are scores of outlays and tax expenditures that ought to be phased out. Along with many others—probably a clear majority of citizens—I have low expectations. People are losing confidence in the federal government.

Something must be done to resolve the situation with Fannie Mae and Freddie Mac; they should not be permitted to remain alive on government life support. They should be phased out, saving billions on the current federal budget in the form of credit subsidies.

If Congress sets Fannie and Freddie on a shrinking path, I myself am optimistic that private firms could pick up the slack quickly. For those less optimistic, a cautious plan is feasible. The two companies should stop their purchases of new mortgages and permit their existing mortgage portfolios to run off as homeowners pay down mortgages in the normal course of business. The companies should announce a gradual increase in securitization fees, which would permit room for private financial firms to enter the business over time. How can Congress permit these two firms to survive? After all, with their proven record of failure costing taxpayers $150 billion and counting, they are not shining success stories. Other high-income countries have successful mortgage markets without GSE-type mortgage subsidiaries. We can, too.

I began my study of economics using the justly renowned textbook by Paul Samuelson. Early in the text is a subheading "The Law of Scarcity." Samuelson points out that, "In the world as it is, even children learn in growing up that 'both' is not an admissible answer to a choice of 'which one.'"

When will American voters and Congress learn that "both" is not an admissible answer when it comes to federal spending?

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Clause 2(g) of rule XI of the Rules of the House of Representatives and the Rules of the Committee on Financial Services require the disclosure of the following information. A copy of this form should be attached to your written testimony.

| 1. Name: | 2. Organization or organizations you are representing: |
|---|---|
| William Poole | None (Self) |

**3. Business Address and telephone number:**

[redacted]

| 4. Have you received any Federal grants or contracts (including any subgrants and subcontracts) since October 1, 2008 related to the subject on which you have been invited to testify? | 5. Have any of the organizations you are representing received any Federal grants or contracts (including any subgrants and subcontracts) since October 1, 2008 related to the subject on which you have been invited to testify? |
|---|---|
| ☐ Yes ☒ No | ☐ Yes ☒ No |

**6. If you answered .yes. to either item 4 or 5, please list the source and amount of each grant or contract, and indicate whether the recipient of such grant was you or the organization(s) you are representing. You may list additional grants or contracts on additional sheets.**

**7. Signature:** William Poole

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