**Transcript of Remarks by Senate Budget Committee Chairman Kent Conrad (D-ND)
at Hearing on Debt Outlook and Its Implications for Policy
January 15, 2009**

Opening Statement

I want to welcome everyone to the Budget Committee today. The hearing this morning will focus on the debt outlook and its implications for policy.

We have a distinguished panel of witnesses: Dr. Richard Berner, the Managing Director and Chief U.S. Economist at Morgan Stanley; Dr. Allen Sinai, President and Chief Global Economist and Strategist at Decision Economics, Inc.; and Dr. Douglas Holtz-Eakin, well-known to this Committee as a former Director of the Congressional Budget Office and who is now President of DHE Consulting, LLC.

We welcome you all. We especially want to welcome back our friend Dr. Holtz-Eakin, who did such a professional job at the Congressional Budget Office, and we thank him for his service. I am pleased that all of you could be with us today, and I look forward to your testimony.

As I have stated before, I believe that the buildup of federal debt is the single biggest threat to our nation's long-term economic security. Obviously, we have a near-term threat of this sharp slowdown, and first things first. We have got to deal with that. We have to put in place an aggressive economic recovery program, but at some point we are going to have to pivot and face up to this burgeoning debt.

The main questions I would like to discuss with our witnesses today are: Does the current buildup in U.S. debt threaten the creditworthiness of the United States? Is there a tipping point where the debt becomes too large in proportion to the size of our economy? And what would be the consequences to the economy and to the budget of a bursting or a deflating of a "debt bubble" at some time in the future?

I do want to make very, very clear that we understand on this Committee fully the need to have an economic recovery package that will add to deficits and debt in the short-term. But this Committee also has a responsibility to our colleagues and to the country to put a focus on the unsustainability of our current fiscal condition, especially in the long-term. Given the retirement of the baby boom generation, given the sizeable additions to the debt that have already occurred, we need to help our colleagues understand what the risk is of a failure to address our long-term imbalances.

The news we received from CBO last week about the deficit was jaw-dropping. We face one of the worst budget forecasts I have ever seen. CBO's new estimates show the deficit in 2009 will be $1.2 trillion. But that is before any economic recovery plan. And of course the increases in the debt will be even more. I believe when it is all said and done that we will probably add somewhere close to $2 trillion to the national debt this year alone.

In fact, we are building a wall of debt. Gross federal debt is now estimated at $11.6

trillion by the end of 2009. And, if we add in current policies, such as extending tax cuts, the alternative minimum tax reform that must occur, and ongoing war costs, we could easily see the debt rise to over $21 trillion by 2019. That would equal about 95 percent of gross domestic product in that year.

Here are some of the major initiatives that are being considered that could further add to that debt: One, the economic recovery package – and again I want to acknowledge the necessity of doing that; two, additional tax cuts; three, health care reform; and four, additional defense spending.

Our long-term debt outlook is even more daunting. Here is a chart from CBO's Long-Term Budget Outlook, which was released in December of 2007. It shows what will happen to federal debt over the next 50 years with the retirement of the baby boom generation, rising health care costs, and the permanent extension of the President's tax cuts. Federal debt will climb to more than 400 percent of GDP by 2058. That is clearly, utterly unsustainable.

Our debt, in addition, is increasingly financed abroad. In 2008, 68 percent of the increase in publicly-held debt was held by foreigners. This presents another risk factor for our economy. If at some time these foreign entities stop buying U.S. debt, interest rates would have to increase in order to attract the capital necessary to float the boat.

Here are the top foreign holders of our U.S. debt. We now owe China $653 billion; Japan $586 billion; the United Kingdom $360 billion; the so-called Caribbean Banking Centers $220 billion; and oil exporters $188 billion; and on and on it goes.

I would like to remind everyone of a point made by former GAO Comptroller General David Walker early last year. He said: "... I believe we have a five- to 10-year window of opportunity to demonstrate to our foreign lenders that we're going to get serious about this. Five to 10 years, and it's closing. And I think it's closer to five than to 10.... Keep in mind, we're the largest debtor nation in the history of mankind, and it's getting worse, not better."

Let me just indicate that about two weeks ago, a major financial figure in this country called me and told me that he is concerned that while he strongly supports the need for an economic recover package in the short-run, that if we fail to address these long-term imbalances, that the currency could collapse. I hope that this hearing today can help us all better understand the risks that are being run and what we need to do to address them.

Additional Comments

Conrad Question: Dr. Sinai, I would like to go back to that paper that you co-wrote in 2004. In that paper, you warned of the risk of a fundamental shift in market expectation and the loss of confidence that could occur when large unsustainable budget deficits are projected. You stated that it is impossible to know when this type of fundamental shift in market expectations might occur, but you noted that if such a shift does occur, the consequences of the resulting "fiscal and financial disarray" would be substantially more negative than the standard projections of sustained budget deficits would predict.

That really caught my attention because as I have discussed with economists of every philosophical stripe in these recent weeks and months, it has come back to me over and over that we are in unchartered territory here, that nobody can be certain of what the reaction might be once recovery is underway and all off these treasuries have to be rolled over, and the United States may find itself in an extremely difficult situation with respect to financing this debt.

Could you help this committee better understand what you see as the potential risk? What are the implications of that risk?

Dr. Allen Sinai Response: I think in the last comments you really have it right, because we will have a recovery in the U.S. economy and the world economy, probably in 2010 of some sort, and then, if you put yourself at that time and look at, as Doug reminds us, once you build in through increased deficits, the debt that goes with it, the deficits might come down some, but the debt is still there and it keeps accumulating, and depending on the pace of growth of GDP you have an increasing burden along with interest charges on it.

And in recovery, interest rates would go up, so the interest charges on that debt would be bigger. And if you were to step back and just play a hypothetical game what would the world look like, you would look at a country with – for the G-7 countries perhaps excluding Japan – the most exposed government financial situation in the history of mankind, once you go to deficits and debt to GDP, and the interest charges on that debt, a country hamstrung for this reason and unable to spend the money because it is not there to do some of the major societal things we need to do. There's just no leeway.

We probably would have very little foreign exchange – we don't have much foreign exchange surplus now. Around the world, you would probably look at a country like China, right now with huge amounts of foreign exchange, so far as we can tell doing a lot of good things on policy, probably going to have a recession, but nothing like what is going on in other countries, now the third largest country by bean counters, ours as well, in the world, dominating Asia and looking ahead asking if I am in an investor, where do I put my money?

Many of these countries have sovereign wealth funds, most countries that have developed huge foreign exchange surpluses over the years and because of our current account deficits we have, and so they are going to have to invest those monies. And they'll look around the world and we'll have a much greater supply of treasuries out there in the market – where will they invest? Their charge is to get a better return. Well even if the Federal Reserve buys all of our treasuries and keeps interest rates low, those returns will be very low, they won't be there. We'll have to buy it. And if we have to buy it in this country, then we have to save to buy it, we can't spend. And if we don't buy it, interest rates go up, the stock market goes down and that reverberates back on hamstringing the economy. Financial institutions do poorly in situations of rising interest rates and falling stock prices. Look at where we are now. Balance sheets of financial institutions shrink. Our financial system, however it looks at that point, will be compromised. The U.S., if you step back and look at it in that situation, it is a bit of a caricature comment, but it would look like a banana republic.

Conrad Response: You know, I wish, Dr. Sinai, that every colleague of ours in the House and the Senate, I wish every American could hear the description you just gave, because what you have just done is connect the dots for people – what happens if certain things occur, what is the

effect on the economy.

I guess one of my greatest frustrations is that around here people look at all this, many of my colleagues, and just get the sense that this is just numbers on a page, and it is not connected much to real people's lives, and those of us who raise these concerns are almost seen as somehow in some other worldly state in which we're not really connected to real people's lives. This is connected to real people's lives. This is not numbers on a page.

I have colleagues say to me, Kent, when you talk about being concerned about these deficits and debt, you don't seem to be concerned about what's happening to that guy out there that is losing his job and can't make the car payment, and can't pay the house payment, and there is a disconnect.

I really feel it very strongly here, between what we're doing as a country here in terms of our fiscal policy and our monetary policy, that it effects real people's lives. These things are directly connected. If anybody thinks this stuff is just numbers on a page, if you are right Dr. Sinai, if you are right Dr. Berner, if you are right Dr. Holtz-Eakin, they're in for one hell of a surprise, and it is not going to be a happy one.