

February 22, 1999

Honorable Charles Rangel
Ranking Democrat
Committee on Ways and Means
U.S. House of Representatives
Washington, DC 20515

Dear Congressman:

This letter responds to your request of February 11 for information about the economic effects of policies that would exhaust the surpluses in the Congressional Budget Office's (CBO's) baseline projections.

As you note, CBO's economic projections are consistent with the general budget outlook under current policies. In recent years, the outlook for the federal budget has sharply improved, more than offsetting a decline in personal saving. As a result of that improvement as well as higher saving in the corporate sector, gross national saving has risen from its low of 14.5 percent of gross domestic product (GDP) in 1992 to 17.3 percent of GDP in 1998. The increase in national saving is expected, all other things being equal, to hold down real interest rates and support continued strong growth in the nation's capital stock. CBO's forecast for interest rates reflects those trends in the federal budget and in private saving, as well as CBO's projections of developments in other countries.

Under current policies, federal debt held by the public is expected to decline over the next 10 years, dropping from \$3.7 trillion at the end of fiscal year 1998 to \$1.2 trillion in 2009 and bringing down the ratio of debt to GDP from 44.3 percent to 8.9 percent. That decline in debt will cut federal interest payments by more than \$500 billion over the 10-year period.

Economists agree that increasing national saving raises productivity and boosts economic growth. With such broad consensus about the positive impact of paying off the debt, perhaps that alternative should be the standard against which all other proposals for use of the surplus are measured. That is, do proposals that increase federal spending or reduce taxes raise productivity and economic growth more than the option of paying down the debt?

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In analyzing such proposals, few generalities apply—that is, not all alternatives are equal. The effects of any alternative to paying down the debt would have to be carefully examined. The details matter, as does the current state of the U.S. economy and of the economies of foreign nations. Some proposals that would appear on the spending side of the federal budget might help productivity; some tax measures might do the same. The analysis must be based on interest rates, for example, that are determined in world markets.

Thus, the effect on the economy of any proposal would depend on precisely how the projected surplus was "used up." We cannot estimate the economic impact of a proposal unless we know the details involved. Our presumption is that paying down the debt is a good thing for economic growth. However, other policies may also enhance growth, and there are certainly policies that may be justified on the basis of objectives other than growth.

In the past, CBO has attempted to provide estimates of the magnitude of such economic effects. As you know, I have just arrived at CBO, and one of my first priorities will be to review CBO's methods for producing those estimates. Until I have completed my review, we will not make any numerical estimates of the effect on the economy of changes in budget policy.

I hope this information will be of use to you. If you have further questions, please do not hesitate to contact me, or your staff may contact Robert Dennis.

Sincerely,

Dan L. Crippen
Director

cc: Honorable Bill Archer
Chairman