

MID-SESSION REVIEW OF THE PRESIDENT'S FISCAL YEAR 2006 BUDGET REQUEST

HEARING BEFORE THE COMMITTEE ON THE BUDGET HOUSE OF REPRESENTATIVES ONE HUNDRED NINTH CONGRESS FIRST SESSION

HEARING HELD IN WASHINGTON, DC, JULY 14, 2005

Serial No. 109-9

Printed for the use of the Committee on the Budget



Available on the Internet:
<http://www.gpoaccess.gov/congress/house/budget/index.html>

U.S. GOVERNMENT PRINTING OFFICE

22-472 PDF

WASHINGTON : 2005

For sale by the Superintendent of Documents, U.S. Government Printing Office
Internet: bookstore.gpo.gov Phone: toll free (866) 512-1800; DC area (202) 512-1800
Fax: (202) 512-2250 Mail: Stop SSOP, Washington, DC 20402-0001

COMMITTEE ON THE BUDGET

JIM NUSSLE, Iowa, *Chairman*

JIM RYUN, Kansas	JOHN M. SPRATT, Jr., South Carolina, <i>Ranking Minority Member</i>
ANDER CRENSHAW, Florida	DENNIS MOORE, Kansas
ADAM H. PUTNAM, Florida	RICHARD E. NEAL, Massachusetts
ROGER F. WICKER, Mississippi	ROSA L. DeLAURO, Connecticut
KENNY C. HULSHOF, Missouri	CHET EDWARDS, Texas
JO BONNER, Alabama	HAROLD E. FORD, Jr., Tennessee
SCOTT GARRETT, New Jersey	LOIS CAPPS, California
J. GRESHAM BARRETT, South Carolina	BRIAN BAIRD, Washington
THADDEUS G. McCOTTER, Michigan	JIM COOPER, Tennessee
MARIO DIAZ-BALART, Florida	ARTUR DAVIS, Alabama
JEB HENSARLING, Texas	WILLIAM J. JEFFERSON, Louisiana
ILEANA ROS-LEHTINEN, Florida	THOMAS H. ALLEN, Maine
DANIEL E. LUNGREN, California	ED CASE, Hawaii
PETE SESSIONS, Texas	CYNTHIA McKINNEY, Georgia
PAUL RYAN, Wisconsin	HENRY CUELLAR, Texas
MICHAEL K. SIMPSON, Idaho	ALLYSON Y. SCHWARTZ, Pennsylvania
JEB BRADLEY, New Hampshire	RON KIND, Wisconsin
PATRICK T. MCHENRY, North Carolina	
CONNIE MACK, Florida	
K. MICHAEL CONAWAY, Texas	
CHRIS CHOCOLA, Indiana	

PROFESSIONAL STAFF

JAMES T. BATES, *Chief of Staff*

THOMAS S. KAHN, *Minority Staff Director and Chief Counsel*

CONTENTS

	Page
Hearing held in Washington, DC, July 14, 2005	1
Statement of Hon. Joshua B. Bolten, Director, Office of Management and Budget	6
Prepared statement of Mr. Bolten	10

MID-SESSION REVIEW OF THE PRESIDENT'S FISCAL YEAR 2006 BUDGET REQUEST

THURSDAY, JULY 14, 2005

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

The committee met, pursuant to call, at 10 a.m. in room 210, Cannon House Office Building, Hon. Jim Nussle (chairman of the committee), presiding.

Members present: Representatives Nussle, Bradley, Conaway, Mack, Putnam, Ryan of Wisconsin, Hensarling, McHenry, Crenshaw, Ros-Lehtinen, Diaz-Balart, Spratt, Neal, Baird, Allen, Cooper, Schwartz, Moore, Cuellar, Jefferson, Edwards, Davis, and Ford.

Chairman NUSSLE. Good morning and welcome everyone, to this Budget Committee hearing. Today, I am pleased to have with us the Director of the Office of Management and Budget (OMB), Josh Bolten.

Welcome back to the House Budget Committee.

He is here today to discuss the administration's midyear update of our Nation's economic and budget outlook, which was released yesterday.

So welcome back to the committee, Director Bolten. As is the tradition, you joined us at the beginning of this year to present the President's budget and your economic and fiscal outlook at that time. This report is an update of those findings.

I think it is useful to review that discussion and to help put this report in context. The first chart, in February, you projected a deficit for fiscal year 2005 of \$427 billion. Today, your projection for the fiscal year 2005 deficit has dropped dramatically to \$333 billion, a reduction of \$94 billion, or 22 percent, over a span of just 6 months.

And since you were with us in February of last year when you estimated the deficit of \$521 billion, your deficit estimate has fallen now by \$188 billion, or 36 percent, more than a third from that estimate. And I understand that these numbers mark the best improvement in the OMB deficit outlook on record for 6- and 18-month periods, it is the incredible shrinking deficit. It is the fastest and deepest correction of deficit on record, and I think it is something that all of us cannot only take credit for, but be proud of. We have work to do, but I think this good news, which we should pause and recognize a little bit about how we got here.

You also reported yesterday that as a share of the Nation's economy, which is really the way to measure deficits, it is the way

Chairman Greenspan measures deficits most, and economists measure deficits; that the deficit for the current year has returned to levels consistent with the average of the past 30 years and that is at about a 2.7 percent level. Now, no one is here to say that we are satisfied, but to suggest that we are somehow at some kind of record amount would, to me, seem unreasonable. We are at a very manageable level if we continue the current management plan we are under. And maybe most important, you projected the surge in revenues and the decline in the deficit will continue beyond the current fiscal year, with the deficit falling to just 1 percent of GDP by 2008 and continuing at that low level through 2010.

Included in that assumption is additional funding for the war, and the policy proposals to fund Social Security. So we are clearly making significant improvement in our budget outlook in a relatively short amount of time.

I don't want anyone to mistake this for just some lucky coincidence or that this good news should somehow precipitate some kind of a new behavior. The good news, you reported yesterday—a strong economy, higher revenues, and falling deficit projections—all of these are a result of successful leadership and policies of the President and Congress to create jobs and control spending.

It is clear the tax relief plan that we passed in 2001, 2002, and 2003 helped to bolster our economic recovery and continues to boost strong sustained economic growth and job creation. And even with accelerated tax relief, our strong economy is boosting tax revenues and driving Federal tax receipts up nearly 15 percent over the same period last year.

No one was predicting back in 2001 coming out of a recession, the gut punch of 9/11, the emergencies, the extra spending for terrorism, and the extra spending for homeland security, that we would have either this fast recovery in the economy this quickly or this kind of sustained growth and ability to pay down this deficit as quickly as we have achieved.

Here is some of the best evidence of our strong economy: Real GDP has increased for 14 consecutive quarters with the strongest growth in 5 years and one of the strongest sustained performances in nearly 2 decades. Over the past 25 months 3.7 million new jobs have been created and unemployment has fallen from 6.3 percent, its highest, just 2 years ago, to 5 percent last month. That means 95 percent of the people who want a job in this country have got a job. Total employment is at a record high of 141 million jobs and people working, and growth in business equipment investment is at its best record level in 6 years.

Home ownership rates are at record highs, and a consensus of the private Blue Chip forecasters—you don't have to believe the Government forecasters; talk to the people who watch this all the time in the private sector, and they say this kind of economic growth and job creation is on track to continue.

Your budget last year on the discretionary spending reminded us of the obvious and that was that the rate we are growing was out of control. And at that time, I think we all were cautiously optimistic that Congress could actually stick to its budget. For the first time in a long time, we slowed the rate of growth in spending. According to your own number, Congress held the spending growth

to 1.4 percent down from the previous 5-year average of 6.3 percent.

This year, not only have we passed all 11 appropriation bills in the House on time and ahead of schedule, but done it with tight limits on spending according to this year's budget resolution. So the budget is doing its part with a strong bipartisan support of those 11 appropriations bills.

So the budget is doing its part; the economy is doing its part; the appropriators are doing their part; this Budget Committee is doing its part; and OMB is doing its part. Everyone is doing a good job and the deficit is falling. Clearly, this is good news for all of us, but we are far from finished.

Of course, we have large deficits in the near term and we have been told not only by you, Director Bolten, but everybody from CBO (Congressional Budget Office) Director Holtz-Eakin to Federal Reserve Chairman Greenspan. And while solid economic growth and controls on discretionary spending are critical in our efforts to reduce the deficit, we must continue, even combined, they are not enough.

With the enormous set of challenges and costs heading our way in the future; including retirement of the baby boomers; skyrocketing medical costs; shoring up the need to sustain the health and retirement systems; we need to get our arms around the largest part of the Federal budget, and that is mandatory spending.

Go to chart No. 7; people have seen this before. Our mandatory spending or our spending that operates on autopilot every year, currently takes up 54 percent of our total budget. On chart 7, you will see that will continue to grow and eventually consume 61 percent of our budget if we don't put some constraints on that spending and some reforms in the process. It would squeeze out every other priority: education; veterans; ag; science; you name it, it is squeezed out if we don't get our arms around Medicare, Medicaid, and Social Security. The spending is going way beyond our means and far beyond our ability to sustain it in the long term.

Nobody should sound the dinner bell today because we have got good news on the deficit and because it is coming down at a record pace. We have seen it as compared to our GDP at one of the lowest rates, no one should get on the gravy train and suggest that now is the time to bust the budget, now is the time to go over our spending constraints and appropriations, now the time is to go further in developing mandatory spending.

I am extremely proud of this committee being at the forefront of this effort. I know we can always suggest that there is more to do, and of course we know there is more to do.

Director Bolten, I commit to you that we will work together, side by side with you, to accomplish the job of continuing to grow the economy, continuing to restrain the nonsecurity spending, continuing to make sure that we reform our mandatory programs to make sure that this good news is sustained far into the future.

With that, I will turn to Mr. Spratt for any comments he would like to make.

Mr. SPRATT. Mr. Chairman, thank you very much indeed. And, Mr. Bolten, glad to have you back and look forward to your testimony.

Mr. Chairman, a spike in revenues is welcome news anytime, but I think in this case, it warrants a wary welcome at most. We have no assurance that these revenues will be recurring, and in any event, they leave the deficit at \$333 billion, making it the third largest in nominal terms on record.

Bear in mind, back in 2001, the Bush administration projected a surplus of \$269 billion for this year, assuming that all their tax cuts would pass. This year's deficit will be \$600 billion off that mark.

Also bear this fact in mind: The bottom line gets worse before it gets better. The deficit OMB projects for 2006 is \$340 billion. That includes only \$13 billion to sustain our deployments in Iraq and Afghanistan. When you adjust for the likely cost for those deployments for the full fiscal year, the deficit for next year 2006 has to be somewhere north of \$350 billion. So it is a little early to start cheering.

Whatever the deficits are over the next 5 years, the deficits over the last 5 years have left us a long-lasting legacy of debt. Even if the debt begins to taper off in 2007, there is a mountain of debt that has been built up since 2001.

When the Bush administration sent us their first budget, on page 3, right at the front, the administration proposed to retire \$2 trillion in debt within 10 years. Far from paying off this debt, the statutory debt ceiling has been raised three times in the last 4 years by \$2.2 trillion to make room for the budgets of the Bush administration. And during 2006 the debt ceiling will have to be raised again by some \$750 billion, over \$3 trillion in debt ceiling increases in less than 5 years. As a result, the Congressional Budget Office observes in its monthly budget review for June, just published, that interest on the national debt has become the fastest growing category of spending in the budget, up \$18 billion, 14.5 percent, this year over last.

Even the Bush administration projects that the cost of interest on the debt will rise by almost \$100 billion between now and 2010. Once more, the buildup of debt doesn't end even if deficits do come down. Let us hope they do.

Look on the last page of the MSR, Mid-Session Review, page 44, Debt Subject to Statutory Limitations. And you will see the debt issued by the Treasury increases from \$7.9 trillion this year to \$10.7 trillion in 2010, a huge spike in the debt.

It is true that revenues collected are up, but they are still below revenues projected. When the Bush administration proposed and sold its budget with big tax cuts in 2001, the Office of Management and Budget at that time projected that the individual income tax would produce \$1.118 trillion in 2004, \$1.118 trillion, assuming its tax cuts would pass. In fact, the individual income tax generated \$809 billion in revenues in 2004; that is \$309 billion less than OMB projected. This revenue shortfall, \$309 billion, accounts for roughly three-fourths of the deficit in 2004.

OMB further projected that the individual income tax will produce and generate \$1.157 trillion in 2005. Based on revenues collected so far, it appears that the individual income tax will generate about \$929 billion in revenues for 2005, \$228 billion less than

OMB projected. This shortfall accounts for about two-thirds of the deficit in 2005.

What should concern all of us is that the spike in revenues that we are seeing may not repeat itself or fully recapitulate. Two-thirds of the increase in individual income taxes over the last 9 months has come in the form of nonwithheld taxes. These are typically taxes paid on one-time capital gains, one-time bonuses, stock options, and the type of income that may not recur.

Beyond 2005, all of your revenue projections assume that the alternative minimum tax (AMT) stays in place. You make no assumption about repairing it, fixing it, replacing it, or repealing it. That means revenues of \$642 billion higher than they would be between 2006 and 2015 if the AMT were fixed to affect no more than the 3 to 4 percent of tax filers who are affected by it today.

Politically, I think it is inevitable we do that, and yet you don't address it at all in your budget, and it has a huge effect on revenues.

Some of the increase in corporate income taxes are due to—actually, increase in taxes are due to the fact that the bonus-expiration provision expired on December 31. The most serious shortcoming of the MSR: It dodges the big event, the elephant in the room. What happens on December 31, 2010, because that is when the tax cuts passed in 2001, 2002, and 2003, the extenders and other things, will come up for renewal.

The Office of Management and Budget's forecast for the future stops after 5 years, or in 2010, so we don't see the effect of extending the Bush tax cuts. Using OMB's March baseline, the best we have got, we picked up where OMB left off in 2010 and we ran the budget out through 2015.

Put up chart No. 5 please, the table; we will have it when we come around to questions then.

Let me tell you what we did, because I think it is very basic and very fair. We assume the Bush tax cuts and the popular tax cuts like the R&D tax cut will be extended and we use the Joint Tax Committee's estimates of what the revenue effects will be.

We assume that the alternative minimum tax will be fixed, politically, we think it is inevitable. The Treasury Department tells by 2010, 30 million Americans will be paying AMT instead of regular taxes, we assume it will be fixed.

We adjust outlays for the cost of our deployments in Iraq and Afghanistan using CBO estimates after 2006. And we take up the President's Social Security proposal at the point he leaves off, extending it from 2010 to 2015. The President put in the first 2 years of implementing his Social Security proposal; we put in the balance through 2015. Here is the result we arrived at, and we show you the chart—a deficit, over \$600 billion, in 2015, and cumulative deficits over \$4 trillion from 2006 through 2015.

So that is why we propose our wary welcome for the latest news of the deficit, for the spike in revenues. We don't see the deficit declining over the long run, 10 years, we see it rising. When realistic items like those I just described are factored into your forecast, we think it will set us back and not move us forward.

If OMB's projections are taken to imply that we are on a path to a balanced budget, we can just sit back and grow our way out

of the budget, we think it is dangerously misleading on the eve of fully phasing in and making permanent all of the tax cuts, leading people to believe that the deficit will keep on declining when in fact it may be about to explode. That is why we propose a wary welcome to the news today.

We look forward to questions that will allow us to probe further the concerns we have, but we thank you for being here and the work you do for our country.

Chairman NUSSLE. Director Bolten, welcome to the committee. Your entire testimony, as written and presented, the report will be made part of the record and you may proceed as you wish. Welcome.

**STATEMENT OF JOSHUA B. BOLTEN, DIRECTOR, OFFICE OF
MANAGEMENT AND BUDGET**

Mr. BOLTEN. Thank you, Mr. Chairman and Mr. Spratt. Thank you for the warm welcome back to the committee and the high tone of the debate that you both set here.

Mr. Chairman, before I begin, I want—I don't normally recognize folks that come with me to these hearings, but I want to depart from that today because joining me at the table today, one seat over to my right, is Dick Emery, who has served in the Federal Government for 39 years, 20-some of those years at OMB. He is the senior civil servant at OMB. He heads our Budget Review Division, which is really at the nerve center of all that OMB does. He is retiring tomorrow, and I just wanted to acknowledge him. He has served Presidents and Budget Directors of both parties with extraordinary capability and loyalty.

I know I speak for a long succession of Budget Directors when I express our collective thanks to him and our best wishes.

Chairman NUSSLE. Congratulations, and we wish you all the best in your retirement. And thank you for your service to our country.

Mr. BOLTEN. Mr. Chairman, I am pleased to send Dick off with some good news.

Since last February, when we released the 2006 budget, the Nation's fiscal outlook has improved dramatically. The U.S. budget deficit is falling and falling fast. The 2005 shortfall will be \$94 billion less than we projected—less than what we projected 5 months ago.

We are seeing what happens when you have a strong economy—more businesses investing, more people working, more income, so Americans can spend and invest as they see fit. We are also seeing more revenues coming into the Federal Treasury.

We arrived at this point, I believe, largely because of this President's policies and this Congress' policies that have promoted growth, especially the tax relief that many members in this room were instrumental in putting in place.

Those policies have strengthened the economy, which is now producing better-than-expected tax revenues. Of the \$94 billion decline in the deficit from last February, \$87 billion comes from stronger receipts, \$7 billion comes from lower-than-expected outlays.

CHANGES FROM THE FEBRUARY BUDGET

(in billions of dollars)

	<u>2005</u>	<u>2006</u>	<u>2007</u>	<u>2008</u>	<u>2009</u>	<u>2010</u>
2006 February Budget deficit.....	-427	-390	-312	-251	-233	-207
Percent of GDP.....	-3.5%	-3.0%	-2.3%	-1.7%	-1.5%	-1.3%
Reestimates:						
Receipts.....	87	95	84	81	77	73
Outlays.....	7	-8	5	10	18	21
Major policy changes:						
Social Security personal accounts.....	---	---	---	---	-23	-56
Additional war funding in 2006.....	---	-37	-10	-2	-1	-0
Total, changes.....	94	49	79	89	71	38
Mid-Session Review deficit.....	-333	-341	-233	-162	-162	-170
Percent of GDP.....	-2.7%	-2.6%	-1.7%	-1.1%	-1.1%	-1.1%

Even as the Nation devotes the substantial resources needed to fight and win the war on terror, the deficit is now forecasted to fall from \$412 billion, or 3.6 percent of GDP, in 2004 to \$333 billion, or 2.7 percent of GDP, in 2005. At its currently forecast level, the U.S. budget deficit for 2005 would be smaller than the deficits in 15 of the last 25 years and, Mr. Chairman, as you pointed out, only slightly above the 40-year historical average deficit of 2.3 percent.

Under the President's fiscal policies, the budget deficit is forecast to continue to fall to \$162 billion in 2009, or 1.1 percent of GDP, less than half the size of the average deficit over the last 40 years. That would significantly surpass President Bush's goal of cutting the deficit in half from its projected 2004 peak of \$521 billion, or 4.5 percent of GDP.

This rapid improvement in the budget picture demonstrates the significance of policies that contribute to sustained economic growth. The implementation of the administration's growth agenda, especially tax relief, restored growth, and investment to the economy after multiple shocks, including a stock collapse, corporate scandals, and the terrorist attacks of September 11. Tax relief proposed by the President and enacted by this Congress in each year from 2001 to 2004 reduced income tax rates, raised incentives for small businesses to invest in new equipment, dramatically reduced the tax rate on dividends, and capital gains and phased out the death tax.

Once fully in place, tax relief produced the desired results. The economy has grown by 12.4 percent since the recession ended at the end of 2001. Employment is up by 3.7 million jobs since May of 2003 and the unemployment rate has fallen to 5 percent, lower than the average unemployment rate in each of the last three decades. Both inflation and interest rates have remained low and business investment is strong.

Our improved budget outlook is largely a product of collections of tax revenue which have grown significantly faster than projected 5 months ago. After 3 straight years of decline due to economic weakness, tax receipts will have risen for 2 consecutive years as of the end of 2005. This Mid-Session Review projects that tax receipts

will rise 14 percent from last year, the largest such year-over-year increase since 1981. Federal receipts as a share of the economy are projected to continue rising in future years as well.

Mr. Chairman, we can't yet identify with certainty the composition of income that yielded this greater-than-expected surge in tax receipts. The detailed data that would permit such an analysis won't be available for many months. The data so far does show, however, that all major categories of receipts—corporate income tax, payroll taxes, and individual income taxes—all of those are outpacing our original forecasts.

This experience of the Federal treasury generally has been matched at the State level, as nearly all States are also reporting income tax collections above forecasts.

Our improved deficit picture in the budgetary window does not rely on assumptions that receipts will continue to grow at this year's rate. Rather, these forecasts are well within the range of experience in times of solid economic growth. With these future gains, Federal receipts are expected to rise to 17.4 percent of GDP in 2005. By 2010, the ratio is projected at 18.1 percent, just about the historical average, even assuming full extension of the President's tax relief program.

Tax relief has had a significant positive impact on the economy, and that stronger economy is the source of the improved tax receipts that we are able to report today. To sustain economic growth, it is critical, Mr. Chairman, that Congress makes tax relief permanent. Allowing this tax relief to expire would endanger the economy's prospects, placing into doubt gains in job creation and business investment that contribute to increases in tax revenues and further reductions in the size of the deficit.

Maintaining a strong economy will also require other progrowth policies. The President's agenda for economic growth includes passing a national energy bill; opening markets abroad through accords like the CAFTA (Central America Free Trade Agreement), which is soon to be before the House; instituting regulatory reforms and limiting lawsuit abuse.

In this and future years, spending discipline will play a vital role in deficit reduction. Each year of President Bush's administration, he and the Congress have brought down the rate of growth in discretionary spending unrelated to defense and homeland security. This committee has demonstrated a continued focus on spending restraint.

I am grateful for the partnership we have with you, Mr. Chairman, and other members of this committee. I know the President appreciates your hard work on behalf of the American people to restrain spending and strengthen our economy.

Thanks to your work, Mr. Chairman, Congress passed a 2006 budget resolution that holds overall discretionary spending to an increase below the projected rate of inflation, and it assumed an actual reduction in nonsecurity discretionary spending compared to last year's level.

Mr. Chairman, I am grateful, too, for the committee's leadership in seeking mandatory savings through the reconciliation process. This committee produced a resolution agreeing to \$70 billion in savings, and ultimately, the entire Congress agreed to \$35 billion

in savings. This is the first time since 1997 that Congress will have employed the expedited reconciliation process to reduce mandatory spending.

As you noted, Mr. Chairman, the House Appropriations Committee has demonstrated a similar resolve. Under the leadership of Chairman Lewis, the appropriations bills have been completed in the House on schedule, all within the limits set by the budget resolution. We also appreciate the House's support during the appropriations process to help meet our goals for halting spending on poorly performing programs. Through this work, the House has agreed to terminate or reduce nearly two-thirds of programs proposed for termination or substantial reduction in the President's budget, achieving more than \$6 billion in savings.

Even so, as you noted, Mr. Chairman, much work remains to be done. The administration looks forward to cooperating with the Congress to produce a final set of spending bills that remain within the President's overall request and achieve a reduction in nonsecurity spending while meeting the Nation's priorities.

The Mid-Session Review we are presenting today contains some items not included in the 2006 budget. The budget resolution passed by the Congress just recently assumes an additional \$50 billion in 2006 for the continuing costs of operations in Iraq and Afghanistan. This review assumes enactment of that funding, which would increase outlays by \$37 billion in 2006 and \$13 billion in 2007 and beyond. The administration expects to request additional 2006 funding from the Congress when requirements for these operations can be estimated more reliably. This review does not reflect the effect of undetermined, but anticipated supplemental requests for operations beyond 2006.

This update also includes the estimated budget impact from the creation of personal accounts under the President's Social Security reform proposal. Transition financing for these accounts would not begin to take effect until 2009 under the President's proposal, and it is easily accommodated within the President's deficit reduction goal.

Although transition financing for Social Security is incorporated into our deficit projections, it should not have the same effect on capital markets as traditional Federal borrowing. First, such financing would bring forward obligations already owed in the form of future-promised benefits, and as a result, would reduce existing future obligations by a roughly equal amount.

Second, unlike debt issued to fund government spending, there would be no net impact on national savings, amounts deposited in personal accounts would be saved in a personal account and invested in the capital markets.

As the Nation's near-term fiscal outlook improves, Mr. Chairman, we have the opportunity and responsibility, as you emphasized, to confront the real fiscal threat—a long-term budgetary picture of steadily rising deficits from mandatory spending programs. President Bush has proposed to address Social Security's long-term insolvency while offering a better deal for today's younger workers. As we continue to address the Nation's long-term fiscal challenges, spending discipline and progrowth policies, especially sustained tax relief, will be essential to our success.

Mr. Chairman, thank you for having me here today and I would be pleased to take your questions.

[The prepared statement of Mr. Bolten follows:]

PREPARED STATEMENT OF HON. JOSHUA B. BOLTEN, DIRECTOR, OFFICE OF
MANAGEMENT AND BUDGET

I am pleased today to report on the Office of Management and Budget's Mid-Session Review of the Budget of the U.S. Government.

Since last February, when we released the 2006 Budget, the Nation's fiscal outlook has improved dramatically. The U.S. budget deficit is falling, and it is falling fast. The 2005 shortfall will be \$94 billion less than we projected just 5 months ago. We are seeing what happens when you have a strong economy—more businesses investing, more people working, and more income, so that Americans can spend and invest as they see fit.

And with all those economic gains, we are also seeing more revenues coming into the Federal Treasury. We have arrived at this point largely because of this President's and this Congress' pro-growth policies, especially tax relief. Those policies have strengthened the economy, which is now producing better-than-expected tax revenues.

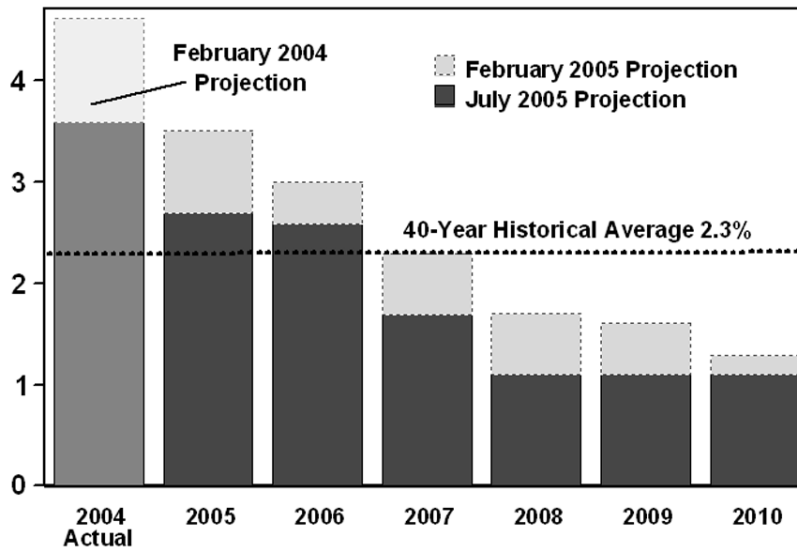
Of the \$94 billion decline in the deficit from last February, \$87 billion comes from stronger receipts; \$7 billion comes from lower-than-expected outlays.

Even as the Nation devotes the substantial resources needed to fight and win the War on Terror, the deficit is now forecast to fall from \$412 billion, or 3.6 percent of GDP, in 2004 to \$333 billion, or 2.7 percent, in 2005.

At its currently forecast level, the U.S. budget deficit for 2005 would be smaller than the deficits in 15 of the last 25 years and only slightly above the 40-year historical average of 2.3 percent.

Cutting the Deficit in Half

Percent of GDP



Under the President's fiscal policies, the budget deficit is forecast to continue to fall, to \$162 billion in 2009, or 1.1 percent of GDP—less than half the size of the average deficit over the last 40 years.

That would significantly surpass President Bush's goal of cutting the deficit in half from its projected 2004 peak of \$521 billion, or 4.5 percent of GDP.

This rapid improvement in the budget picture demonstrates the significance of policies that contribute to sustained economic growth. The implementation of the Administration's pro-growth agenda, especially tax relief, restored growth and in-

vestment to the economy after multiple shocks, including a stock market collapse, corporate scandals, and the terrorist attacks of September 11, 2001.

Tax relief proposed by the President and enacted by Congress in each year from 2001 through 2004 reduced income tax rates, raised incentives for small businesses to invest in new equipment, dramatically reduced the tax rate on dividends and capital gains, and phased out the death tax.

Once fully in place, tax relief produced the desired results: The economy has grown by 12.4 percent since the recession ended in November, 2001. Employment is up by 3.7 million jobs since May of 2003, and the unemployment rate has fallen to 5 percent, lower than the average unemployment rate of each of the last three decades. Both inflation and interest rates have remained low, and business investment is strong.

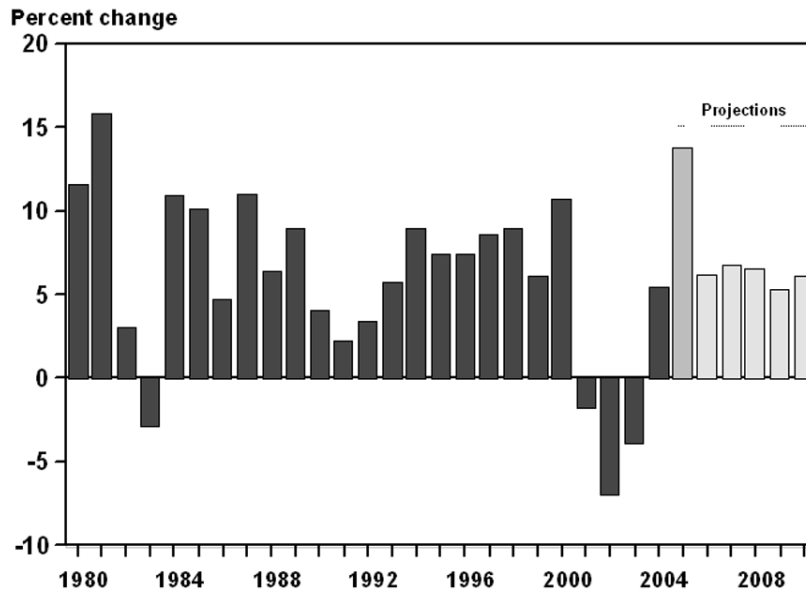
Our improved budget outlook is largely a product of collections of tax revenue, which have grown significantly faster than projected 5 months ago. After three straight years of declines due to economic weakness, tax receipts will have risen two consecutive years. This Mid-Session Review projects that tax receipts will rise 14 percent from last year—the largest such year-over-year increase since 1981. Federal receipts as a share of the economy are projected to continue rising in future years as well.

We cannot yet identify with certainty the composition of income that yielded this greater-than-expected surge in tax receipts; detailed data that would permit such an analysis will not be available for many months.

The data so far do show, however, that all major categories of receipts—corporate income taxes, payroll taxes, and individual income taxes—are outpacing forecasts. This experience of the Federal Treasury generally has been matched at the state level, as nearly all states are reporting income tax collections above forecasts.

Our improved deficit picture in the budgetary window does not rely on assumptions that receipts will continue to grow at this year's rate. Rather, these forecasts are well within the range of experience in times of solid economic growth.

Strong Economy = Strong Receipts



With these future gains, Federal receipts are expected to rise to 17.4 percent of GDP in 2005. By 2010, the ratio is projected at 18.1 percent, just about the historical average, even assuming full extension of the President's tax relief program.

Tax relief has had a significant positive impact on the economy, and that stronger economy is the source of the improved tax receipts that are reported today. To sustain economic growth, it is critical that Congress make tax relief permanent. Allowing this tax relief to expire would endanger the economy's prospects, placing into

doubt gains in job creation and business investment that contribute to increases in tax revenues and further reductions in the size of the deficit.

Maintaining this growing economy will also require other pro-growth policies. The President's agenda for economic growth includes passing a national energy bill, opening markets abroad through accords such as CAFTA, instituting regulatory reforms, and limiting lawsuit abuse.

In this and future years, spending discipline will play a vital role in deficit reduction. Each year of President Bush's administration, he and Congress have brought down the rate of growth in discretionary spending unrelated to defense and homeland security.

This Committee has demonstrated a continued focus on spending restraint. I'm grateful for the partnership we have with you, Mr. Chairman, and other members of this Committee; I know the President appreciates your hard work on behalf of the American people to restrain spending and strengthen our economy.

Thanks to your work, Congress passed a 2006 Budget Resolution that holds overall discretionary spending to an increase below the projected rate of inflation, and assumes an actual reduction in non-security related discretionary spending compared to last year's levels.

I am grateful, too, for the Committee's leadership in seeking mandatory savings through the Reconciliation process. This Committee produced a Resolution agreeing to \$70 billion in savings, and ultimately, the entire Congress agreed to \$35 billion in savings. This is the first time since 1997 that Congress will have employed the expedited Reconciliation process to reduce mandatory spending.

The House Appropriations Committee has demonstrated a similar resolve. Under the leadership of Chairman Lewis, the appropriations bills have been completed in the House on schedule, all within the limit set by the Budget Resolution. We also appreciate the House's support during the appropriations process to help meet our goals for halting spending on poorly performing programs. Through this work, the House has agreed to terminate or reduce nearly two-thirds of programs proposed for termination or reduction in the President's Budget, achieving more than \$6 billion in savings.

Even so, much work remains to be done. The Administration looks forward to cooperating with the Congress to produce a final set of spending bills that remain within the President's overall request, and achieve a reduction in non-security spending while meeting the Nation's priorities.

The Mid Session Review we are presenting today contains some items not included in the 2006 Budget. The Budget Resolution passed by the Congress assumes an additional \$50 billion in 2006 for the continuing costs of operations in Iraq and Afghanistan. This Review assumes enactment of this funding, which would increase outlays by \$37 billion in 2006 and \$13 billion in 2007 and beyond. The Administration expects to request additional 2006 funding from the Congress when requirements for these operations can be estimated more reliably. This Review does not reflect the effect of undetermined but anticipated supplemental requests for operations beyond 2006.

This update also includes the estimated budget impact from the creation of personal accounts under the President's Social Security reform proposal. Transition financing for these accounts would not begin to take effect until 2009, and is easily accommodated within the President's deficit reduction goal.

Although transition financing is incorporated into our deficit projections, it should not have the same effect on capital markets as traditional Federal borrowing. First, such financing would essentially bring forward obligations already owed in the form of promised future benefits, and as a result, would reduce existing future obligations by a roughly equal amount. Second, unlike debt issued to fund government spending, there would be no impact on net national savings, because every dollar of transition financing would be saved in a personal account and invested in the capital markets.

As the nation's near-term fiscal outlook improves, we have the opportunity and responsibility to confront the real fiscal threat: a long-term budgetary picture of steadily rising deficits from mandatory spending programs. President Bush has proposed to address Social Security's long-term insolvency while offering a better deal for today's younger workers.

As we continue to address the nation's long-term fiscal challenges, spending discipline and progrowth policies, especially sustained tax relief, will be essential to our success.

Chairman NUSSLE. I appreciate your testimony and I appreciate the willingness you have to come before this committee and come up to the Hill and talk to us individually.

I don't have any questions at this point. I think I have made my statement pretty clear and so I will defer my question time. And I will recognize Mr. Spratt for—just so members, know, my understanding is we have four votes at any point here, so I wanted to give Mr. Spratt the chance to ask those questions.

We may have a vote and recess for that vote, so just so members are alerted to that schedule. Mr. Spratt.

Mr. SPRATT. Mr. Director, thank you again for your testimony. Let me clarify what you are doing here in this so-called Mid-Session Review.

What you are doing here is updating the budget submission you made in February based upon what has happened to revenues and what has happened to spending in the interim in preparation for our bringing to final conclusion all of the budget in the latter months of this fiscal year. In other words, you have reflected the increase in revenues. You have reflected some expenditure reductions and increases that weren't included.

But this is the tip of the big pyramid, and the base of the pyramid is the February budget and it is still part of the assumption on which you are resting your presentation this morning. Let me show you what I am driving at.

From pages 19 to 44, you have recapitulated the major items in your 2006 budget. You assume taxes and spending will be enacted and carried forward in the projection you make here. For example, just picking a few things at random: Perkins loans, I picked them, \$5.9 trillion, almost \$6 trillion. We are going to go to the colleges that have been allowed to keep those funds and revert the funds to the Federal Treasury. You are assuming that that will still be made law somehow—\$5.9 billion.

I will lower the price tag for you.

Mr. BOLTEN. I knew it was a lot.

Mr. SPRATT. Still part of your assumption.

Mr. BOLTEN. Are we continuing to assume the President's proposed policies in our budget projections? The answer is yes. Both those that save money and those that cost money, not all of which we are likely to achieve.

Mr. SPRATT. You would allow them to raise their prices, market rates, as opposed to having a rate fixed upon historic cost. That generates about \$12.4 billion in revenues.

I am not telling you, but throwing out some things that are highly controversial that I doubt will be enacted by this Congress; but they are assumed in your budget both with respect to revenues and expenditure reductions. We are still assuming then, the PMA price setting was changed as a matter of law?

Mr. BOLTEN. We are continuing to assume all of the administration's policies, both those that cost money and those that save money. We don't anticipate getting all of them, but my expectation is, there will be an offsetting effect between the two of them; and we will, in fact, as we did last year, come out roughly where we expected to come out, or as we are this year, even better.

Mr. SPRATT. As I read the charts, you are also expecting over 10 years a \$42-billion reduction in the cost of Medicaid, still assuming that \$12-billion reduction over the first 5 years, \$42 billion over the full 10 years?

Mr. BOLTEN. I don't have the exact numbers off the top of my head, but I believe that is roughly accurate. In the budget resolution adopted by this committee and the Congress there is a substantial reduction likely from Medicaid, assuming that will be accomplished through the reconciliation process.

Mr. SPRATT. As I recall, it was \$10 billion over 5 and no designation of what it would cost in the outyears.

One thing that is built into your baseline automatically is an adjustment in physician payment rates under Medicare as a result of something called the "sustainable growth rate," which is a policy administered by MedPAC. As I understand what you presented here, you say that certain things are going up, but they have been offset by the decrease in physicians' pay and double medical equipment rates that will be dictated by the sustainable growth-rate factor.

Are we still assuming that for 10 full years there would be percentage reductions every year for 6 years and no recovery of that in the baseline for Medicare spending? Physicians' pay will be cut this year, next year, and the following year with no restoration of it, it is a big number. If you simply froze it in place, I understand that the cost will be \$50 billion as opposed to what is built into the baseline with the implementation of this sustainable growth-rate factor.

Mr. BOLTEN. Mr. Spratt, we do assume the continuation of existing law. That sustainable growth rate is part of the Medicare law that was adopted by the Congress and signed by the President.

Mr. SPRATT. You are not proposing a change in the law?

Mr. BOLTEN. That is the law until there is such a change or we have put in our budget requests a proposal to change it, then we do assume it. I understand there will be a great deal of interest in making some modification in that sustainable growth rate. My hope and expectation is, we will be able to do that within the budget levels that have been agreed to.

Mr. SPRATT. The point I am driving at is that all of these are fairly significant items, particularly when you take them in the aggregate, and they are all controversial; and I would say there is an odds-on chance of not making it through this budget season.

A lot of this stuff you are proposing has been around the track many times. You would propose to charge \$250 to 7 and 8 Category veterans to use the veterans health care facilities. I think that is about as dead a duck as there is in Congress. It is not going to happen, and it is still here.

You would propose to have the USDA pay to have the food inspectors paid by food processors. That has been around—for the 20 years I have been in Congress, it has never passed.

There is a lot of stuff built into your assumptions and baseline, that bottom of the pyramid, that I don't think is going to happen; and it is going to have a big effect on your bottom line unless we come up with alternative policies—and I don't know what they are going to be—that will make up the difference.

Mr. BOLTEN. Mr. Spratt, that makes the point I was trying to make and that is, we assume in our budget projections the implementation of the President's proposal, which is the proper thing to do and always has been done.

Mr. SPRATT. The question I am raising, is it realistic to make those assumptions at this point in time?

Mr. BOLTEN. I think it is.

Mr. SPRATT. Do you think it is realistic that Congress would pass a \$250 fee for veterans?

Mr. BOLTEN. We can talk about the veterans policy. But the point I am getting at is, we have in fact proposed that policy in the past and we have in fact come in at or below the aggregate spending levels, just as we are this year.

The point I am trying to make is, yes, we include all of our policies. Some of our policies save money, some of our policies cost money; we don't expect to get all of them.

When we get to the final budget tabulation at the end of the year, we will be at or maybe even better than where we expected to be at the end of the year. We are ending up with a final deficit figure very much lower than we expected to end up with, and yet we have many of those same policies that ultimately were not enacted assumed in our budget. We had other policies that would have cost money that weren't adopted.

Mr. SPRATT. The point I am trying to make is, if a major part of your budget is based upon politically unrealistic assumptions about fees that have been proposed and rejected in the past, then the results you are holding out may not be attainable.

Mr. BOLTEN. I think the results we are holding out are entirely attainable, and our record shows not only are the results attainable, but in fact we can exceed them. We are exceeding our expectations this year in just the last 5 months by \$94 billion.

Mr. SPRATT. Let us go to revenues, because that is the biggest development since last February.

Last February you had a pretty robust estimate for this year and next year with respect to revenues. It now turns out it wasn't robust enough. The revenue growth has been even greater than anticipated. I think you have added \$87 billion to 2005. You are adding \$95 billion to the baseline, already a substantial number for 2006. And over the 5-year forecast, you are adding \$406 billion to what you are projecting in the way of revenues back in February.

Most of the spike that we are seeing in revenues, if you take individual income tax, for example, is based upon factors that may not be recurring. It is 66 percent of the increase in individual income taxes over the last 9 months is attributable to nonwithheld income, which means typically taxes levied on stock options, salary bonuses, and capital gains, which may or may not be repeated in the following year.

I believe you used to be an employee of Goldman Sachs, let me show you Goldman Sachs.

Mr. BOLTEN. I am smiling.

Mr. SPRATT. We have been preempted by the floor.

Mr. BOLTEN. I remember the days when I made a lot more money.

Mr. SPRATT. You didn't get to deal with big numbers like this.

Here is what Goldman Sachs says. We see the prospects for additional cyclical reduction limited to 2005. The tax bonanza has been concentrated in the final settlements of 2004 tax liabilities. This is why it suddenly appeared in April and May. Thus the lion's share

of this year's extra tax receipts reflects last year's strong profits, and that means conditions are not conducive.

You have carried these increments that have been added this year and assume they will repeat themselves over the next 5 years. Do you think that is defensible?

Mr. BOLTEN. I think we have made very moderate projections going forward. First of all, with respect to the analysis you have just identified, I have great respect for and I know the folks who produced these estimates, but I don't think they are suggesting that our estimates are necessarily far off, No. 1.

And No. 2, this same team projected last year that the deficit in 2005 would be \$450 billion. We are actually coming in at \$333 billion, and that is just over the course of a little more than a year that this team's calculations have been off.

We are indeed making, very moderate projections going forward. The increase in revenue this year at over 14 percent, as the chairman pointed out, is remarkable. It is the largest increase in revenue in 25 years, maybe the largest real increase in much longer than that. We are not assuming, however, that we are going to get that kind of 14 percent increase year over year.

If you will look at—Mr. Spratt, if I may call up a chart. If I could call up chart 6, what you see there in the medium blue line is 2005, where we have receipts going up 14 percent. In the years succeeding that, our projections show receipts growing by about 6 percent, which is entirely consistent, in fact a relatively moderate expectation for years of solid growth in the 3 to 3.5 percent range, as we are now projecting.

Mr. SPRATT. That 16 on a pretty big base, because you have the \$87 billion, \$95 billion additions, assuming that the surge will carry forward.

Mr. BOLTEN. Two points about that. First, with respect to those elements that may have been—that may be one-time in this 14 percent increase, we were aware of those. Those are things like the bonus depreciation, the repatriation of profits, and even some of the elements of the increase in individual income tax; and those were accounted for in our 2005 estimates.

But more than that, as you look into the outyears and you look at historical precedent, when an economy is growing, there is very little precedent for an actual fall in revenues from the base you are operating from. So in terms of—

Mr. SPRATT. I am not saying your fault, whether the surge at today's level can be predicted forward. You do taper it off a little bit. I notice the numbers, but 8 into—5 into 406 comes out to \$80 billion a year. You have a fairly substantial increase there that you are assuming will carry forward.

Mr. BOLTEN. I think so, but I think the projections going forward are quite moderate and based on moderate assumptions on economic growth.

Mr. SPRATT. I have one more question, and we will be back.

Chairman NUSSLE. We will resume following the final vote on the floor.

[Recess.]

Chairman NUSSLE. We will resume the budget hearing. Mr. Spratt indicated that he had one final—

Mr. SPRATT. Just in time.

Chairman NUSSLE. All right. I was actually going to preserve your chance and go to Mr. Neal. But I will let you ask—you said you had a final question. And then we will go to Mr. Neal.

Mr. Spratt.

Mr. SPRATT. Mr. Director, I would like to show you our effort to try to extend this 5-year forecast to a 10-year forecast using assumptions about numbers that are either yours or CBO's, and this is a bit crowded. Do you have a copy of it in front of you so that you can see it?

Mr. BOLTEN. I do, Mr. Spratt, and I appreciate the courtesy of your staff in bringing it to me during the break.

Mr. SPRATT. What we have tried to do is take this chart through 2010, using your numbers, and then match it with the CBO baseline for March of this year, and it is an uneven match. I will grant you there is not a complete interface there, but nevertheless we have connected the two.

And when you look at the bottom line, the very bottom line in red, you will see what concerns me. The reason I ended my testimony, my statement, with the concern about the dire results we are looking at in those years, and why we don't think that we are looking at a situation where the deficit is going to decline and disappear. In fact, if all of the tax cuts renew, if the popular tax measures like the R&D tax credit renewed, if all of these renewed as of 2010, if the AMT is fixed—and we think politically it has to be, Treasury Department tells us 30 million tax filers will be paying that AMT instead of the regular rate in 2010—if you assume those things, if you put in the cost of the war—and let me tell you what that is. We are assuming here as CBO assumed, they did a model. CBO in effect said, look, we are not comfortable putting in the full amount of the supplemental and running it out for 10 years, we think that overstates the cost of the war; on the other hand, zero doesn't give you an accurate forecast. So they tried to determine what would be, in the second 5 years from 2010 through 2015, what would be a fair approximation. And what they have assumed is that beginning after 2006, the number of troops will draw down in Afghanistan and Iraq to about 20,000 in each theater, 40,000 altogether, and that level will be maintained as a steady state for the whole time frame here. The cost of that is \$384 billion.

We have assumed that the first 2 years of the implementation of the President's Social Security privatization plan will be enacted as you presume. Heretofore when we have done that, we have been on rather tenuous ground, but now you put those two numbers in your budget, so we are just hooking up 8 more years of what we expect to be the likely cost of that in the first 10 years, per the actuaries at Social Security. When you put all of that together, the bottom line after 2010 goes dramatically upward from \$275 to \$478 to \$481 billion in 2012 to a deficit of \$534 billion in 2013, to, finally, a deficit of \$629 billion in the year 2015. The cumulative deficit for 2006 through 2015 will be \$4.2 trillion. I don't think you would call that a desirable result. Where are we wrong?

Mr. BOLTEN. Mr. Spratt, I believe the assumptions are wrong in many places. First of all, in those subsequent 5 years that are outside the budget window that we project and publish, you are using

a CBO baseline that I expect even CBO doesn't agree with at this point, because you are using their March baseline, and my guess is that when they come out in August this will improve as well. We have not consistently agreed with the CBO baseline as the right way to go forward, even if we were back in March.

Second, I am gratified that you have assumed the inclusion of \$173 billion in transition financing for the President's Social Security personal accounts. May I report to the President that this reflects some support on your part.

Mr. SPRATT. On Social Security?

Mr. BOLTEN. Yes, sir.

Mr. SPRATT. I wouldn't want to misrepresent that to the President.

Mr. BOLTEN. All right. I will defer on that, but I am gratified that you have included that number in there.

Mr. SPRATT. I am simply picking up with where you left off using the actuaries' numbers.

Mr. BOLTEN. But I do want to highlight that number in particular, because the—as I mentioned in my prepared testimony, the transition financing that does need to be incorporated into our deficit calculations is very different from the addition of government spending because it is not in the aggregate adding to the overall debt of the United States in any substantial way. When we do transition financing for these personal accounts, that is merely bringing forward an obligation that the Federal Government already owes to the retirees, letting them keep and invest some of their own money sooner than the Government would otherwise have to pay it back to them later.

Mr. SPRATT. But instead of having a balance in the Social Security trust fund resulting from the surpluses being accumulated there to about 2018, that money would be put in a private account, and therefore the surplus in the Social Security trust fund will be smaller as an offset to the rest of the budget.

Mr. BOLTEN. Sure. And the obligations that the Government owes to that retiree later would correspondingly be smaller. What I am emphasizing here about that—

Mr. SPRATT. But for bookkeeping purposes, I think it will be just as we booked it here. I think it will still diminish the unified surplus.

Mr. BOLTEN. Absolutely. But what I am pointing out here is that you would have to recognize the deficit effect, as we do in our own budget calculations going up through 2010, we would have to recognize the deficit effect of those—of allowing people to keep some of their own money in personal accounts.

What I am pointing out is that is very different from increases in government spending which, overall, add to the long-term debt of the United States. I am assuming that, and in fact we should anticipate that along with the creation of these personal accounts there would be other reforms made to Social Security that would make the system sustainable on a long-run basis, bring it back into solvency. And I think the effect of all that on the budget cannot be viewed as anything other than a tremendous improvement over time.

Mr. SPRATT. But you are arguing effects now, the economic effects. What I am arguing for starters is just the bottom line; what are the numbers going to be. Look at the subtotal, the President's omitted agenda beginning in the year 2011. This is the sum of the further cost of the war, an AMT fix, and Social Security privatization for the most part, including debt service after those adjustments are made: \$211 billion in 2011; \$251 in 2012; \$289 in 2013; \$329 in 2014; and an additional \$373 billion in 2015.

Aren't those numbers pretty much by the book? Wouldn't you agree that if these policies are implemented we would have—or carried forward, we would have an adjustment to our bottom line in those relative magnitudes?

Mr. BOLTEN. I think what I was trying to say, Mr. Spratt, is that I don't agree at all to the assumptions, and I don't think any fair observer would agree with the—as I said, the continuation of the CBO baseline. I don't think a fair observer would anticipate necessarily that we, in 2015—that is, 10 years from now we would be spending \$28 billion on the war in Iraq and Afghanistan.

And with respect to the AMT that you have incorporated some calculations in there, the administration does believe that the AMT needs to be reformed. We believe that it can be reformed in the context of an overall budget-neutral fundamental tax reform.

So I don't—I have to say I don't accept any of the assumptions that produce these numbers. And from my perspective, I don't think they at all change the outlook or the fundamental trajectory, the very positive trajectory on which our budget deficit situation appears to be headed not just in the next 5 years but in the years beyond.

Now, if I can add one thing, Mr. Spratt. If you were to take this chart even farther out, I would be in complete agreement with you that we face a very serious problem that the chairman himself highlighted in his opening statement, and that is the tremendous unfunded liability in our entitlement programs: Social Security, Medicare, and Medicaid. That problem arises because of the retirement of the baby boom generation, the explosive growth in health care costs that we have experienced over the last several decades, and the actuaries project will continue, and those are problems that I think need to be addressed on their own.

There is, in my judgment, there is nothing that can be done—even if we were to take your view of increased taxes, there is nothing that could be done on the basis of taxes or discretionary spending that could alter that trajectory in any substantial way. We need fundamental reform of our entitlement programs. But if what you are asking me about is the next 5 years, probably even the next 10 years, I believe our budget trajectory is very positive and based on very sound policy.

Mr. SPRATT. But you sort of make my point, which is this is no time to be running huge deficits. We should be saving and preparing for the extraordinary demands that our entitlement systems and our aging society will impose upon us in the very foreseeable future. Indeed, if we kept our books the way the rest of the world and the whole business community keeps its books, by accrual accounting, these numbers would look several times worse than they apparently do, particularly since these are liabilities we know we

have incurred already. These are not promises that are empty promises. We have promised people things based upon things they have done in reliance upon our promise; and knowing that, we should be booking those liabilities.

But I am simply saying to you, I think adjustments of the magnitude we have got here for the omitted agenda are reasonable.

Let me ask you about the alternative minimum tax. As long as it is on the books with no adjustment, no patch or anything, it means that you will actually have sort of a tax increase by virtue of the AMT. It is kind of a hidden increase in the budget, because every year people pay higher than the posted rates of taxes who are affected by the AMT. Wouldn't you agree it has to be fixed, changed, or repealed; something has to be done before it reaches \$30 million tax dollars?

Mr. BOLTEN. Yes, the administration does agree that the AMT tax—

Mr. SPRATT. But you don't have that anywhere in your projections over the next—

Mr. BOLTEN. We believe that the AMT can and should be reformed in the context of overall budget-neutral fundamental tax reform.

Mr. SPRATT. And you would agree there is going to be some significant cost for Iraq and Afghanistan certainly after 2006, and probably for some years to come.

Mr. BOLTEN. I was explicit about that in my testimony. But what I wouldn't agree to is that by 2015 anybody can tell us that we are spending \$28 billion in Iraq and Afghanistan.

Mr. SPRATT. Well, that is 20,000 troops in Iraq and 20,000 troops in Afghanistan and in the theater, it is about two divisions. Let us hope we are not. I hope you are right on that one. But it is not an unrealistic assumption on CBO's part. We will have a substantial troop presence. Particularly in a place like Afghanistan; 20,000 troops in a country that size is not a large assumption.

Mr. BOLTEN. Mr. Spratt, I don't know how anybody can pre-direct what the situation there will be in 2015 or in fact whether— if there is to be a continuing presence there a full 10 years from now, whether that is not entirely absorbable within the regular defense baseline.

Mr. SPRATT. Well, the bottom line that we are not sharing today is we are looking after 2010 and we see some dire results after 2010; by our calculation, a deficit in the year 2015 of \$629 billion and a total accumulation of debt of over \$4 trillion. So that gives us grave concern, No. 1, that we are not on the path to a declining deficit. And No. 2, if people get euphoric about today's numbers, it may take some of the unktion, some of the impetus for moving forward and making those hard decisions away from us.

Mr. BOLTEN. Mr. Spratt, I want to endorse your call against irrational euphoria and second the chairman's comment that this is not the time to ring the dinner bell, this the time to redouble our efforts at spending restraint. I believe the President's budgets reflect that, and we look forward to working with you to accomplish their objectives.

Mr. SPRATT. Thank you, sir.

Chairman NUSSLE. Mr. Bradley.

Mr. BRADLEY. Thank you very much, Mr. Chairman. Pleasure to be here this morning.

Director Bolten, I am glad that you are here with good news on the budget. Going from \$521 billion projected a year or so ago to \$333 billion is indeed not just a step in the right direction but significant progress. And I think it is important to note that a growing economy is incredibly important for that, coupled with fiscal restraint.

And so I am pleased that your message has stayed that we need to continue to grow the economy and exercise fiscal restraint.

Let me, since I am on both this committee and the Veterans' Committee, let me touch on briefly an issue where there has been some projection snafus, and thankfully, due to, among others, the leadership of the chairman of this committee as well as the administration, progress made to fix those veterans' spending problems.

But my question is: Are you assured that the projections that you have given us over the last couple of weeks—there is the \$975 million shortfall and now potentially another \$300 million in this fiscal year and perhaps as much as \$1.7 billion in fiscal year 2006—are you relatively assured that those numbers now are accurate and they will not change again?

Mr. BOLTEN. Mr. Bradley, thank you for that comment and thank you for the question. We did have a substantial error in our 2005 and 2006 calculations in the amount of money that would be needed for veterans medical care. The error was based principally on a miscalculation of how many veterans would be coming new into the system. The Veterans Administration was projecting about 3 percent less than the 5.2 percent increase in the population that they ultimately are now seeing coming into the system in this year in 2005, and we now have to project forward into 2006.

Secretary Nicholson has done a good job of trying to get his hands around that problem. I know that you and some other members of the committee have been very actively involved in ensuring that he does do that. He has taken a very careful look at their projections. He has taken a very careful look at how the mistake was made and how we can prevent it in the future. And I think he has made a great deal of progress in that and he has the full support of OMB in ensuring that, because the President's direction to me on this matter is, as it always has been, to ensure that our veterans get the best possible quality care and the care that they have been promised and the care they are entitled to.

Mr. BRADLEY. Thank you for that answer. I am pleased that you have taken steps in working with Secretary Nicholson to rectify the situation, make sure that the projections are correct in the future. And I hope that you can address this if you wish. Part of taking those steps is to increase transparency of budgeting, working with some of the outside veterans groups on the budgeting, and perhaps you can address that.

But the second part of my question, and perhaps we could have slide No. 17, is the improved quality of care of the Veterans Administration hospitals and the facilities. There have been a couple of newsworthy news reports, both in "U.S. News and World Report" and the "Washington Monthly," that have talked about the improving quality of care at the VA. And my question to you is that 10

years ago that wasn't the case, and there were a number of reports that said the quality of care was not that good.

Would you discuss the changes that have been made to turning around that quality of care that is so important for our Nation's veterans? And perhaps as I look at these charts, that has a major component in why we have been able to turn that around.

Mr. BOLTEN. Mr. Bradley, this administration came in with a high-priority task of ensuring that our veterans got the best possible quality health care. Historically that has not always been the case, and I think we have made tremendous progress in the 4½ years since this administration has been in place. I think Secretary Nicholson can report today that we are serving more than a million more veterans than we have in the past with better-quality health care on a faster basis than they have ever been able to do before.

You noted some outside reports. I noticed that one of my colleagues just passed me an article that you referenced from "U.S. News," entitled "Military Might: Today's VA Hospitals are Models of Top-Notch Care." Now, this is not a case for complacency. There is still a great deal more that Secretary Nicholson believes needs to be done. There are still many elements of veterans health care that need to be improved—both in terms of dollars, as the chart you have just put up shows, and in terms of commitment to ensuring high-quality care. I think the record has been and will remain a very strong one.

Mr. BRADLEY. If I might just have a few more seconds, Mr. Chairman, certainly anecdotally when I talk to veterans in my district, they are always concerned about the level of funding, but I always hear the quality of care is dramatically improving. Your or Mr. Nicholson's former predecessor, Secretary Principi, was very helpful in my district in opening up a new outpatient clinic, and those have been a tremendous success. So I would agree with you that there is always work to be done. But the VA health care system is among the best health care in our country today and certainly you and Secretary Nicholson and Secretary Principi deserve credit for that. And I thank the Chairman for yielding me the few extra seconds.

Chairman NUSSLE. I thank the gentleman. One note of concern that I would forward is that obviously a lot of attention has been given to the underprojection this year. As I understand it this is on the heels of I believe at least 2, maybe 3 years of where we had more than enough resources available in VA health. So, I don't know if it is as much of a question, as it is a concern that we do want to hit this a little bit more on the dime, and it is difficult to budget without having accurate projections. I realize that is singing to the choir, because you can't do it either. This is the concern, and it makes news when it is underprojected, but this is not news. This has, unfortunately, been a projection challenge that has been ongoing for the last couple of years.

I don't know if there is anything there that you would like to comment on, Director, but that is an observation that I have. We have got to hit this a little bit tighter if we are going to be able to make plans for the future in our VA health and VA budgets.

Mr. BOLTEN. Mr. Chairman, if I may comment briefly. I think you are absolutely right. And there have been 3 consecutive years

preceding this one in which there was more money requested by the administration and more money appropriated by the Congress for the medical care portions of the veterans services than was actually needed in that year. I think the appropriations have exceeded the VA medical care needs by over half a billion dollars in each of the proceeding 3 years. So our calibration—

Chairman NUSSLE. I don't remember any complaints about over-projection.

Mr. BOLTEN. Our calibrations haven't been precise and you certainly want to—in the case of VA medical care, I think you certainly want to overshoot than undershoot. The President and I know Mr. Bradley, other members, and you were all committed to ensuring that there is never a shortfall in what we provide our veterans.

If I can add one other comment, though, to Mr. Bradley's comment, and that is that indeed the reputation and I think the reality of the quality of care in the VA system has improved substantially in recent years. This may have contributed to the additional unexpected inflow of veterans into the system, because it is an increasingly attractive system, particularly compared to what is available in the private sector. Secretary Nicholson believes that that may have contributed to the size of the unexpected inflow of the veterans into the system. That is not to excuse the error, but it must be a partial explanation.

Chairman NUSSLE. Thank you. Mr. Neal.

Mr. NEAL. Thank you very much, Mr. Chairman. I think part of that is also the number of veterans who are using the prescription drug benefit of the VA? Is that a fair assessment?

Mr. BOLTEN. My guess is it is. And my guess is the prescription drug benefit is one of the attractions that draws a lot of members into the VA.

Mr. NEAL. So you have people that perhaps might not have used it in the past, but because of the cost of prescription drugs they have moved in that direction.

Mr. BOLTEN. Yes. What Secretary Nicholson told me is that you often have a situation where a veteran who is otherwise eligible for veterans care, but is getting his care elsewhere in the private sector but not getting prescription drug coverage, decides to go over to the VA to get the prescription drugs. They find out that they like the system overall and move all of their health care over into the VA system.

Mr. NEAL. OK. Thank you, Mr. Bolten. Let me ask you, when can we expect next year to receive a supplemental request for the wars in Iraq and Afghanistan?

Mr. BOLTEN. I don't know that we will depend entirely on the actions on the ground. What I can tell you is that the \$50 billion reserve that this committee put into the budget resolution, which we are assuming in our projections going forward, will take us substantially—assuming that level or something like that level is actually enacted by the Congress, which I think is a reasonable expectation—will take us substantially into 2006. Exactly how far into 2006 it will go. I will continue to argue that we should wait as late in that process as possible before requesting supplemental funding

so that we can get as precise an estimate as possible of how much money we will actually need before we make that request to you.

Mr. NEAL. Well let me ask you then, Mr. Bolten. You can state with certainly, however, there will be a request for a supplemental next year?

Mr. BOLTEN. No, I can't state with certainty, but with a high degree of likelihood I think.

Mr. NEAL. OK. You mentioned that any fair observer, before when you were responding to Mr. Spratt's questions. Do you think Lawrence Lindsey was a fair observer of the budget process and the needs for dollars for Iraq and Afghanistan?

Mr. BOLTEN. I think Larry Lindsey is a brilliant economist and I am sure others would say he is a fair observer.

Mr. NEAL. You know where I am going, Mr. Bolten. You know exactly where I am going. How come when he suggested that it was going to cost at least \$300 billion, the reaction from the administration was so negative? I mean, the administration said that in some instances we are going to be welcomed as liberators; and others, we would be out of there in no time. And recently, I mean, a high-ranking member of the administration suggested that the insurgency was in its last throes.

And I am just curious as to why, when Mr. Lindsey raised the specter of a \$300 billion price tag, that there were such long frowns at the White House.

Mr. BOLTEN. I don't recall exactly what it is that Dr. Lindsey said.

Mr. NEAL. He said it was going to cost \$300 billion at minimum.

Mr. BOLTEN. Well, regardless, I recall—

Mr. NEAL. You picked the term "fair observer," Mr. Bolten. Any fair observer, I think you said. That is what we are trying to be here today, fair observers.

Mr. BOLTEN. Dr. Lindsey, I don't recall what his projection was, I don't recall the context. I don't recall even the frowns at the White House.

Mr. NEAL. Would you recall that he was relieved of his responsibilities shortly thereafter? You don't recall that either?

Mr. BOLTEN. No, I do recall that he left. I don't think there was any connection at all.

Mr. NEAL. Do you want to check with your assistants that are here about that \$300 billion price tag? Would they agree with the number that I have offered?

Mr. BOLTEN. It doesn't matter to me to answer this question.

Mr. NEAL. That is the point. The point that I am trying to make, Mr. Bolten, is I understand precisely what you are saying. It is very hard to gauge what this is going to cost. But that is the trouble when we look at—and I was a cosponsor with Mr. Weller of the depreciation issue, and I think you would agree that that has bumped up revenue.

Mr. BOLTEN. I am sorry. Which proposal?

Mr. NEAL. The accelerated depreciation exploration.

Mr. BOLTEN. Yes.

Mr. NEAL. So would you agree that that has bumped up revenue?

Mr. BOLTEN. Yes, and that was included in our projections when we made our initial projection in 2005.

Mr. NEAL. And it is hard to suggest, for example, that all of the numbers that you have given us today have just been based upon administration strategy, isn't it, given the fact that we all know that we are going to need another supplemental for Iraq come perhaps next spring? I know administration officials have suggested to me that it could be in February or March of next year. Is that a fairly accurate suggestion?

Mr. BOLTEN. I don't know when it will come forward. My expectation is we will need additional supplemental funding for the wars in Iraq and Afghanistan.

Mr. NEAL. And in the past, the two supplementals have not been put on budget; is that the case?

Mr. BOLTEN. They have been emergency supplementals, which I believe was then, is now, and will be the right way to handle any sort of war funding.

Mr. NEAL. OK. I appreciate you responding to the question.

But there are a lot of uncertainties, and I think that it is also fair for those of us who are a bit more skeptical on this side to at least raise the specter, these numbers being a temporary snapshot as opposed to a long-term snapshot, I think as Mr. Spratt has accurately pointed out.

Thank you, Mr. Chairman.

Chairman NUSSLE. Thank you. Mr. Ryan.

Mr. RYAN. Thank you Chairman.

Let me just add on to what my friend Mr. Neal said. And then I just had a question about tax receipts. Slide No. 14 is what I am going to reference.

Each year we have our deficit projections, we have our budget projections. The administration has their policies, Congress enacts its policies. It all comes out in the wash and the macro effect that we have seen is the deficit is down by a historic precipitous drop. And so in years past, we have had supplementals for Iraq and Afghanistan. We may have acted on some of the administration's policies, and we may not have acted on some of the administration's policies. That happens every single year.

Taking all of that into effect, I think it is important to note that we have an incredible thing happening here. The deficit went down by \$94 billion this year. We are down from \$521 just a year ago, from our projections. That is good news, and that is very, very important.

So what I wanted to simply ask you, Mr. Bolten, is I realize, you know, we want to take you for everything that you have in your budget that you propose and if we don't hit that, that is going to blow up our deficit projections; but we have not ever acted on everything that the administration has proposed in its budgets, yet we are still overperforming against the benchmark that we have plodded toward in performing on reducing this deficit. And one of the things that is doing this are income tax receipts and tax receipts in general.

And so the question that I just really want to ask, which is really interesting to me, on slide No. 14, if you take a look at 2002 we had a large drop in tax receipts. In 2003 we had a significant drop in tax receipts. And in July of 2003, that is when the tax cuts were enacted. Now, the 2001 tax cuts were tax cuts that were slowly

phased in over time. The 2003 tax cuts were the acceleration of those 2001 tax cuts in addition to the—I think the bonus depreciation. So the tax cuts actually took effect really in 2003, in July I believe it was; and so then you see immediately thereafter, in 2004, a surge in revenues. In 2005 we have this huge \$260 billion increase in revenues.

So the question I have, Mr. Bolten, is to what extent since those tax cuts passed have we increased revenues above what we projected them to be? And how much of that is attributable to this declining deficit?

Mr. BOLTEN. Well, first of all, Mr. Ryan, I think you have stated the case better than I did to begin with. You are exactly right that the revenue projections that we have, the good news we have today is the result of increased revenues coming into the Treasury as a direct result of economic growth that was ignited, I believe, by the tax cuts.

The numbers you point out are accurate. The 2003 tax cut, which accelerated the reductions in rates, brought them forward. The following year, with those tax cuts fully implemented, was a year of rising receipts, after the first 3 consecutive years of falling receipts since the 1920s.

Mr. RYAN. So income tax receipts went up as well.

Mr. BOLTEN. Yes.

Mr. RYAN. So we lowered income tax rates, yet after that lowering of those rates, the rates from those lower tax rates were actually higher than they were before at the higher tax rates.

Mr. BOLTEN. They were indeed.

Mr. RYAN. What is the difference in projections? I think, you know, Austin may have that behind you there. What is the difference in projections that you had from 2003 on up when those tax cuts took place?

Mr. BOLTEN. Mr. Ryan, I may have a number for that. If I don't have it at my fingertips I will submit it for the record, because it is a very substantial number. However, I don't have it fingertips.

	2003	2004	2005	2006	2007	2008	2009	2010
FY04 (Jan 03)	1,836.2	1,922.0	2,135.2	2,263.2	2,398.1	2,520.9		
MSR06 (Jul 05)			2,139.7	2,272.7	2,427.8	2,588.3	2,726.5	2,893.3
Delta			4.5	9.6	29.8	67.4		

As the chart shows, the Administration has raised its revenue forecast for the comparable years since the 2003 tax cuts were proposed. In the aggregate, the Administration now forecasts receipts to be about \$111 billion higher over the overlapping 3-year period from 2005 to 2008, with an annual difference of \$67 billion in 2008.

Mr. RYAN. That is something I would be interested in seeing and we will get it later.

The last point or question I have is Mr. Spratt correctly lined up the fact that we do have a tax tidal wave coming in this country at the end of the decade. We have the alternative minimum tax coming in each year. We have the President's tax cuts going away.

In your baseline you do project, don't you, that we are going to extend those tax cuts, correct?

Mr. BOLTEN. Our baseline assumes the permanent extension of all of the President's tax cuts except for those like the bonus depreciation which were intended to—

Mr. RYAN. Which were already temporary. And I would just simply say—as a member of Ways and Means who serves on this committee as well—to Mr. Spratt that, you know, that is the reason we are having a tax commission, to rethink how we can better have a tax system to make us more internationally competitive, have a fairer, simpler tax system to improve our economy. But also to fix some of these problems that are on the horizon; not just the lack of permanency for these tax cuts and expiring provisions, but things like the alternative minimum tax. That is why we do have the President's Commission coming back, I think at the end of September now, to visit these issues.

So it is not as if that is an issue that is just hanging out there that no one is paying attention to. Not only does OMB and this committee budget in our projections the extension of those tax cuts, we are also trying to think through how best to move forward with respect to the AMT and these other tax provisions so we can get this kind of success that we are seeing here today.

I see my time has expired so I thank you, Chairman.

Chairman NUSSLE. Thank you. Mr. Allen.

Mr. ALLEN. I remember it wasn't so long ago when Alan Greenspan sat in that chair, and when asked about the effect of tax cuts, I think he accepted the tax cut reduction in taxes on dividends. But other than that, he said there is no significant continuing effect from the tax cuts passed in 2001 and 2003. That is what I recall.

I have a specific question, and I am not going to—I can't call Alan Greenspan back to testify today, but that is my very clear memory of what he said.

I wanted to ask you, Mr. Bolten, a question about the Medicaid program. The President's budget proposes deep cuts to the Medicaid program, and the actuaries at HHS (Health and Human Services Department) have estimated gross savings of \$20 billion over 5 years and net savings of \$12 billion over years. When the CBO reviewed the President's proposals, they were unable to provide estimates for many of them due to a lack of detail. Representatives Spratt and Dingell sent a letter to you on April 13 of this year asking for more information about the administration's Medicaid proposals. The letter expressed a concern, which I share, that cutting Medicaid will merely shift cost to the States, which are already struggling with their own financial problems; secondly, to beneficiaries who can ill afford them; and third, to providers in the form of lower payment rates.

The letter that was sent on April 13 requested estimates of the impact on States' analysis of the effect on beneficiary cost-sharing and coverage and the effect on provider groups. Representatives Spratt and Dingell have yet to receive an answer to that letter. And I will be glad to provide you with a copy.

But the question is: Can we expect an answer soon—and by what date—to that particular letter? I will hand it to your staff.

THE WHITE HOUSE,
OFFICE OF MANAGEMENT AND BUDGET,
Washington, DC, June 20, 2005.

Hon. John M. Spratt, Jr.,
Committee on the Budget, House of Representatives, Washington, DC.

DEAR REPRESENTATIVE SPRATT: Thank you for your letter of April 13, 2005, regarding Medicaid proposals included in the President's FY 2006 Budget.

We support Congress's effort to restrain spending growth within the Federal Budget in the recently passed FY 2006 Budget Resolution. The President's FY 2006 Budget was designed to accomplish the same goal by addressing program integrity challenges currently facing Medicaid, which provides health insurance for more than 46 million Americans. Many States believe Medicaid's rules and regulations are overly burdensome, and the State-Federal financing system remains prone to abuse.

The President's FY 2006 Budget proposed a range of program integrity proposals designed to restore the credibility of the Federal/State matching system and address other payment concerns. The program integrity proposals would help reduce payment inefficiencies and curb questionable financing practices that have been used by a number of States to avoid the legally determined State matching funds requirements.

Now that Congress has passed the Budget Resolution, we look forward to having further discussions with Congress on the specific Budget proposals. The Administration has not yet submitted any Medicaid legislation related to the FY 2006 Budget, but is eager to pursue our proposed reforms. We will continue to discuss these proposals with Congress as the authorizing committees develop their legislative proposals for FY 2006.

Thank you again for your interest in the Budget and Medicaid. We look forward to working with the Congress to develop workable policies to make the Medicaid program more efficient while continuing to provide critical access to health care.

Sincerely,

JOSHUA B. BOLTEN,
Director.

Mr. BOLTEN. Thank you, Mr. Allen. We will provide, if we have not already done so, we will provide a prompt response.

But what I would like to say about the proposals in the President's program on Medicaid, which I very much hope will be taken up by the Congress and adopted in the reconciliation process, are not drastic cuts in the Medicaid system. They are proposed savings that will reduce the rate of increase in the cost of the Medicaid system from about 7.4 percent annually to about 7.2 percent annually. So the alarm that has been sounded about a drastic cut, I think is entirely unwarranted.

Second, the President's proposals do not depend at all on reducing the provision of care to beneficiaries. What the President's proposals go to is program integrity to ensure that the Federal Government is paying only its fair share vis-a-vis the States, or even vis-a-vis individuals. We have a number of individuals who are out there who are effectively gaming the system by asset transfers and so on. The President's proposals are directed to trying to clamp down on the various games that have been played to attract Federal money where it does not belong, not an attempt to try to dig in at all on beneficiaries who are the poor people who need these medical services and the people we are trying serve.

Mr. ALLEN. I understand that. And I certainly agree that those who are gaming the system need to—that issue needs to be dealt with, both with respect to individuals who are transferring their assets to family members so that they can qualify for Medicaid, and I understand you have issues with the way some of the States calculate their Medicaid reimbursement from the Federal Government. But back home at the State level, the kind of reductions that

are being talked about in my State, and my understanding is around the country, are not perceived that way. They are perceived as reductions. And whether it is the rate of increase or the absolute amount makes no difference to the States because they have rising demand for Medicaid services all the time both in terms of costs and the number of people covered. And so it is perceived that the only way the States can cope with the kinds of reductions that are being proposed is by cutting benefits. Do you have a—

Mr. BOLTEN. Well, I think what that highlights is that as Medicaid costs skyrocket, it is not just the Federal Government that bears an additional burden. It is really the States that are bearing the most difficult burden, which I think should be directing the conversation toward a rethink and reform of the way that we approach Medicaid so that we are sure that we are focusing our dollars on those most in need; not just for the benefit of the Federal Treasury but for the benefit of the State treasuries as well, which are increasingly stressed by their Medicaid obligations.

Mr. ALLEN. I have just one very quick follow-up. You have included estimates for Medicaid cuts of \$12.2 billion in your projections. CBO says the number is \$7.6 billion. The budget resolution we passed says \$10 billion. Isn't the \$12.2 billion number that you have used overstating the savings, if either of the CBO or the budget resolution itself is the more accurate number?

Mr. BOLTEN. I don't think so. I think it is a disagreement among the scorekeepers and actuaries as to what an individual policy will produce, and I think it is a legitimate disagreement that experts can disagree on. We believe that ours is more accurate. The fundamental point is that I don't think the policy changes are based on that. They are, I believe, good policy changes regardless of how much you believe they will ultimately save the Federal Treasury.

Mr. ALLEN. OK. Thank you very much. I appreciate your being willing to respond to that letter promptly. Thank you.

Chairman NUSSLE. I am just wondering, does the administration have a response to the letter requesting the Democratic leadership to appoint Members to the Medicaid Commission so that we can actually go through and reform the proposal, consider options, and consider what the Governors have called probably one of the most unsustainable policies that they have to deal with? I am just wondering if the administration has gotten a response to that letter yet.

Mr. BOLTEN. Interesting question, Mr. Chairman. I don't know whether there has been a formal response. I do know that there has been no effort to contribute Members to that commission.

Chairman NUSSLE. That is kind of what I thought. Mr. Crenshaw.

Mr. CRENSHAW. Thank you, Mr. Chairman.

And thank you, Director, for being here today and bringing the good news about the economy growing and the deficit shrinking. And I know you believe, and I believe a lot of people believe, that the tax relief that we put in place has a significant impact on the economy and therefore revenues have grown. You let people keep more of what they earn, they get to decide how to spend, to save it, and invest it. But the other part is putting the brakes on spending that I think has helped bring about this good news.

And I have the privilege of sitting on not only this Budget Committee but also the Appropriations Committee. And after we wrote the budget that when you take out homeland security and defense spending, the actual discretionary spending went down this year I think .8 percent. And the Appropriations Committee kind of followed the budget guidelines, adopted the spending bills, and the full House has now passed all of those. And so we have that in front of us.

So we have kind of—I hope, as we have seen the tax relief work and then we have seen controlling spending work, part of that has to be evidenced by the good news that we see here today.

So let me ask you a little bit about both sides of that. On the tax relief side, I think you just said that your projections include making permanent these tax relief packages we put in place, and I think that is good news. But we haven't done that yet. And so could you comment on what happens if we don't make those tax cuts permanent, which kind of is also another way of asking what if we hadn't have put these tax relief packages in place to start with, where would we be today? I don't think we would be talking about the good news that we have.

But could you comment on that, on your view of where tax relief has brought us, and then what would happen if we didn't go ahead and make permanent the tax relief that we put in place before?

Mr. BOLTEN. Mr. Crenshaw, thank you. Let me look back first and say where would we be today in the absence of the tax cuts that the President proposed and you all enacted. I think history will judge those tax cuts as among the best-timed and most effective tax cuts in the economic history of the United States. There have been a number of economic studies done that demonstrate that putting in place the tax relief in the way that you did and at the time that you did was essential to bringing growth back into the economy and especially to bringing job growth back into the economy.

According to one study I believe done by the Treasury Department, there would have been in 2004, 3 million fewer people working in the absence of the tax cuts than actually ended up working, because we got the economy growing again. So that is looking backwards.

Now, I don't think anybody can fairly disagree with that assessment now looking back in history. Looking forward, we do have a number of people disagreeing that we need to keep these tax cuts in place. I think it is essential that we do so. Raising the tax rates at this point, beyond what is included in the Tax Code as it now exists, in other words repealing some portion of tax cuts that you all put in place; whether it is the rates; whether it is the child credit; or the small business expensing, all of those elements I believe are important to sustaining the good economic growth that we are projecting out into the future years. We are not projecting spectacular economic growth, we have made conservative estimates. We are projecting growth in the 3 to 3½ percent range mostly out over the next 5 years.

In order to realize those moderately good revenue increases that are on the chart that Mr. Spratt and I were talking about at the beginning of this hearing, we need to have that economic growth.

If we don't have that growth, I believe that revenues will fall far off of our expectations, and our deficit situation could be substantially worse.

Mr. CRENSHAW. Thank you. Let me ask you just finally the question of—as we watched the deficit shrink so dramatically. Talk about your view of the deficit in terms of raw numbers, in terms of a percentage of GDP. I mean, where are we kind of historically; because it seems to me after this dramatic drop, the projected deficit being a little over \$300 billion, where does that fit kind of in a perspective over the last 10 years, as a percentage of GDP or as a raw number? Because it certainly appears when it drops that dramatically, that that has to be good news.

Mr. BOLTEN. If I may, Mr. Crenshaw, let me put back up chart 5, which shows our projections of the deficit as a percent of GDP. I emphasize, that is actually the right way to look at a deficit in the context of what are the resources available in our economy to pay off the debt created by that deficit. The dotted line you see there is the 40-year historical average. That is 2.3 percent over the last 4 years is the average deficit, it is the average budget position of the United States over the last 40 years. You will see that with these new numbers, we are bringing the 2005 deficit very close to that level. What we expect actually to happen is 2.7 percent. That is just .4 percent over the 40-year historic average.

Looking back over the last 25 years, assuming we do end up at 2.7 percent of GDP in 2005 that will be a smaller deficit than we have experienced in 15 of the last 25 years. It is not a place to stop for satisfaction. It is not a place, as the chairman emphasized, to ring the dinner bell, but it is a place to say well done so far; the economic plan is working.

Now, we have more to do to ensure that we keep economic growth going forward and to ensure that we are not overspending while we are experiencing that growth.

Mr. CRENSHAW. Thank you. Thank you, Mr. Chairman.

Chairman NUSSLE. Mr. Cooper.

Mr. COOPER. Thank you, Mr. Chairman. I want there to be good news on the deficit. As policy cochair to the Blue Dog Coalition, we would welcome an administration's success on the deficit. But we also want the truth. We want facts, not fiction. I am a little worried that particularly my Republican colleagues may be a little overexcited today with the so-called good news that has been presented.

Mr. Crenshaw mentioned earlier that he is an appropriator and that we have good news on spending reductions. Well, let me put in for the record the Cato Institute report which points out that the record for this administration is not one that you would want to brag on. The title of the report is called—and this is by Stephen Slivinski—it was issued May 3, 2005. It is called "The Grand Old Spending Party: How Republicans Became Big Spenders." And it says in its summary that President Bush has presided over the largest overall increase in inflation-adjusted Federal spending since Lyndon B. Johnson. Even after excluding spending on defense and homeland security, Bush is still the biggest spending President in 30 years.

His 2006 budget, which you have recently revised projections on, doesn't cut enough spending to change his place in history either. So the time for self-congratulation is way premature.

You had mentioned, especially in response to Congressman Spratt's question, that you are assuming the implementation of the President's proposals. Well, you probably know the old schoolyard phrase, "The word 'assume' makes an ass out of you and me."

Will the President of the United States enforce his budget by using his veto power or his rescission power or both, twin powers that he has never used in his Presidency? We have had no adult supervision of this Congress because President Bush is the first President since James Garfield in 1881 never to have used his veto, and poor Garfield was only in office for 6 months. President Bush has never used his rescission power. President Clinton used it 163 times and president Reagan used it 602 times. But after 5 years, President Bush has never used his rescission power. So it is not enough to assume that the President's budget will be implemented.

Y'all have let Congress run the show and Congress is not known for its fiscal restraint. We need a partnership here between the White House and Congress because the President's budget assumes, for example, \$12 billion in Medicaid cuts. Well, the President will have the ability to enforce that. The President's budget assumes \$10 billion in student loan cuts. Well, the President has the ability to enforce that. Will he do it?

That is the challenge that we face, because getting overexcited about a relative decline in the size of the deficit looks a little ridiculous, because that means basically we are going to borrow a little bit less money from the Chinese this year to fund our overspending.

It is like the navigator of the Titanic saying, well, the iceberg isn't as far off as we thought. It is little further off than we thought.

Mr. Bolten, you are a very intelligent man and you know that your former employer is questioning a lot of the estimates you are making, because a business entity like Goldman Sachs looks at a more complete picture than artificial and constrained budget rules that we are obligated to use in this body. And the real budget deficit, even according to your numbers, seems to me to be these.

While the deficit may look like \$333 billion projected, you will also be borrowing \$176 billion. From whom? Our Nation's seniors, by borrowing from the Social Security surplus.

So the real deficit, the on-budget deficit that our Nation faces, even according to your own numbers, is over \$500 billion. In fact, it is \$508 billion. Is that a cause for celebration or relief? Is that good news? Granted, it is slightly less huge than we thought, but it is still the third largest deficit in American history.

And the other two prize winners were also contributed by this White House.

Now you can say with some reason it is not, as a percentage of GNP, quite as large as some others, but this is not a record to be proud of. It took the first 204 years of our Nation's history to accumulate 1 trillion in debt. And now we are doing it almost every 18 months. And there has never been a President since Lyndon Baines

Johnson to have sanctioned this much spending. And there hasn't been a President since James Garfield never to have used his veto.

Will this policy change?

Mr. BOLTEN. Mr. Cooper, I will endorse your call for a partnership between the Congress and those, including on the other side of the aisle, who have a genuine interest in forcing discipline. The President certainly does. He has had one and will continue to have one.

On his behalf, on dozens of occasions last year, I included in Statements of Administration Policy a veto threat on appropriations bills if they exceeded the limits to which the Congress had agreed in its budget resolution and which the President had presented in his budget, the President's senior advisors would recommend that he veto the bill. In no case, Mr. Cooper, as the bills came down to the President for signature was it necessary for the President to exercise that veto because those appropriations lived within the budget limits that were set by the Congress in the budget resolution and in the President's budget. I anticipate we will be achieving similar success this year.

The President's 2006 budget on the discretionary side asked for that discretionary spending to grow by no more than the rate of inflation, which is around 2.4 percent total discretionary spending and that there be an actual cut in the nonsecurity elements of discretionary spending. As Mr. Crenshaw and the chairman both emphasized, this House has delivered on that, has delivered appropriations bills. If the House versions were adopted, that would keep overall discretionary spending below the rate of inflation and would produce an actual cut in the nonsecurity elements related to that.

I am very hopeful, as we take those bills into conference with what is produced in the Senate, we will come to a final resolution that produces those results that the President asked for, as they did last year which precluded the need to exercise a veto.

On Social Security, Mr. Cooper, you are absolutely right that it has been the practice of this administration just as it has been the practice of administrations for decades going back, Democrat and Republican, to count the budget deficit on a unified basis, that is, including the Social Security surplus in the deficit calculations. That is the practice of CBO and the practice of everybody who looks at it. It is the right way to look at the borrowing needs of the United States because it is our cash position.

If the concern is that money is being taken from the Social Security system and spent on current needs with just an IOU for the future, I would submit to you that the best way to prevent that from happening is to ensure individual retirees are able to keep money in their own accounts and invest it as they see fit rather than putting it into the Treasury coffers to be spent by the Federal Government.

Chairman NUSSLE. Mr. Edwards.

Mr. EDWARDS. Thank you, Mr. Chairman.

Mr. Chairman, I am glad we are not adding over a billion dollars a day to the deficit, as we have been over the last several years, having gone from the highest surplus in the American history to the highest deficit. But I have a hard time thinking, Mr. Bolten, that my two children, two sons who are 8 and 9, are going to cele-

brate as a historically positive event tax cuts that help take us from the largest surplus to the largest deficits in American history.

And I have a hard time believing—while they may not understand it today, a hard time thinking that they will someday thank the administration and leadership in Congress for only adding this year \$912 million a day to the national debt burden on their backs. When my children wake up tomorrow morning, they will have nearly a billion dollars more on their backs than they did today. I don't find that cause for great celebration. In fact, I think it is one of the powerful statements made today, how much the Republican leadership and Congress has changed—I think, in my opinion, even out of touch with a lot of Republican grass-roots thinking that we should celebrate a budget that is going to be \$333 billion in debt added to our \$7 trillion-plus national debt.

The fact is, this is the third largest deficit in American history. The fact is, without the Social Security surplus, this year's deficit would be more than a billion dollars a day; in fact, I believe more than half a trillion dollars in 1 year.

We have the largest trade deficit in American history. So the reality is that some of the economic growth we are seeing today is like a drug-induced high, except this time the drug is the deficit, and selling off American manufacturing, and basing jobs in foreign countries and borrowing money from them. And now we are starting to see the end result in what I think is unbelievable fiscal policy, the Chinese wanting to buy American oil companies. That is one of the end products of this unsound fiscal policy in my opinion.

What really concerns me, if you look at classical economics, it would say that in a time of relatively low unemployment—which you are heralding, Mr. Bolten—and strong economic growth, we should have a surplus this year, not a huge deficit. And I don't think that portends well for the future.

Let me point out, the fact is that the promise of reducing the deficit, that the administration's own policies created to reduce its own self-induced deficit by half over the next few years, is assuming we are going to balance that budget or reduce that deficit on the backs of veterans. I will say today, as I have said for the last 2 years, this administration has underfunded veterans health care services.

The VA health care crisis we face in America right now should be a surprise to no one. It was not a surprise to the disabled American veterans last year, this year, or the year before last year. It wasn't a surprise to the American Legion, and it wasn't a surprise to the Veterans of Foreign Wars. And it wasn't a surprise to the Democrats on this committee, myself included, who offered 2 years in a row amendments to add \$2 billion to VA health care, which we said was needed to prevent cuts in veterans health care services during a time of war. Those amendments were rejected by virtually every Republican on this committee and not supported by the administration.

I am glad, Mr. Bolten, OMB is now saying, the administration did get it wrong, and we are underfunding VA health care. But I do want to point out, I hope every veteran watching this today, Mr. Chairman, heard Mr. Bolten speak on behalf of the administration

in saying, in his opinion, we funded the VA health care system too much money for about 3 years running.

Let me go on the record and say, every major veterans organization in America will vehemently disagree that we funded too much money for VA health care over the last several years. The reality is, some of that reserve fund that I assume you are referencing was being saved because the underfunding of the VA budget was so bad our VA administrators knew they had to cut out some very important services this year and last year to cover the shortfall that the administration was proposing.

My question to you, Mr. Bolten: Does the administration stand by its projections for VA health care spending for the next 5 years? If so, do you admit that that is going to cause a cut in veterans' health care services? And if you don't stand by that projection, are you admitting that the country shouldn't really trust the numbers you are projecting that would reduce the deficit by half?

Mr. BOLTEN. Mr. Edwards, let me address the veterans situation and emphasize, what I was stating about the previous 3 years of veterans funding was a fact, and that is that the administration requested more than what was actually needed to be spent on veterans medical care. The Congress appropriated more than what was needed to be spent.

Mr. EDWARDS. With that, I disagree strongly.

Mr. BOLTEN. The record will reflect that very clearly, and it was contained in carryovers from year to year within the veterans care budget.

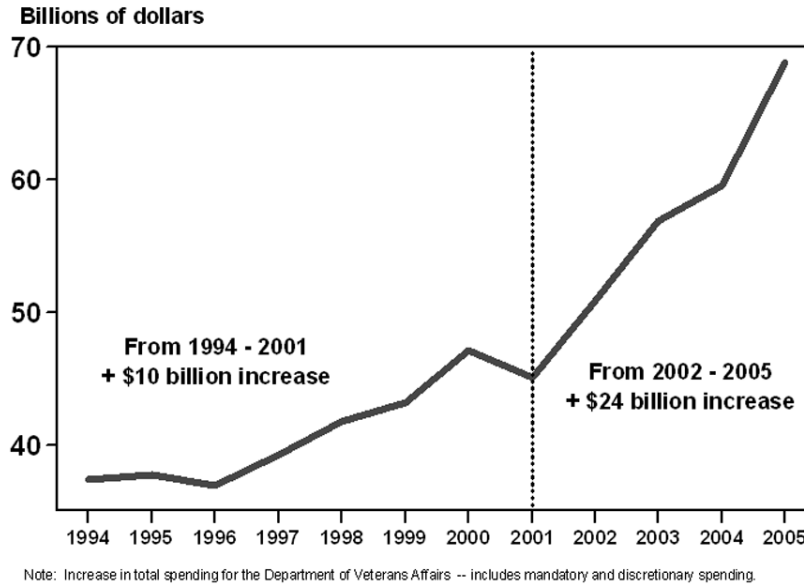
If I can—put up chart 16, if we can. I think this graphically demonstrates, Mr. Edwards, this administration does not have a record of underfunding our veterans' needs. What you see here is that over the course of the preceding 8 years, spending within the Veterans Administration grew by \$10 billion. Over the course of the succeeding 4 years, it increased by \$24 billion.

We can go back a second to chart 15. The bulk of that increase was in veterans health care spending. The blue line represents the medical care spending, what you see, that has been increased by a total of 50 percent over the last year.

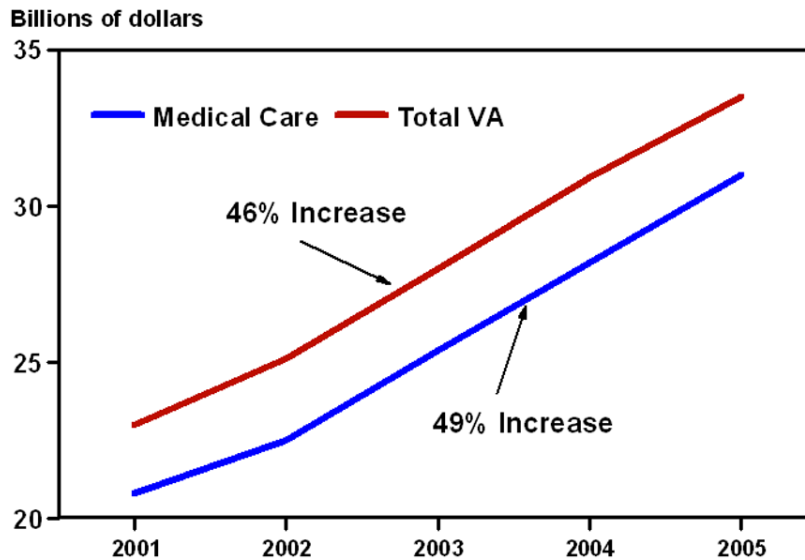
Mr. EDWARDS. Didn't the number of veterans increase?

Mr. BOLTEN. It did, by about 1 million people. With the various reports that I discussed earlier with Mr. Bradley, I think the report from the field has to be that over the course of the preceding years. The quality and the speed of care that our veterans are getting has improved, has improved dramatically, and may be one of the reasons why we are getting so many more veterans than we expected into the system.

Increased Spending for Veterans



Veterans Discretionary Budget



Now, as to our projections going forward, as to our calculations about how we will fully meet the needs of our veterans, as soon as the administration recognized that we did, indeed, have a shortfall, that there had been a miscalculation about how many veterans were coming into the system, Secretary Nicholson sought the addi-

tional funding. We got \$1 billion in additional supplemental funding in 2005.

There will be a 2006 budget amendment forthcoming that will take care of all of the needs we anticipate. I want to be sure that we are clear on the record that this administration's record on veterans medical care funding, I believe, is very strong.

May I take 30 seconds, Mr. Chairman, and respond to one other thing in Mr. Edwards' presentation?

Mr. EDWARDS. Mr. Chairman, if you extend his time, will you extend my time by the same amount?

Chairman NUSSLE. You asked one question at the end and expected him within 3 seconds to answer the question. I have been very generous with time. I will give the witness an opportunity.

Mr. EDWARDS. Just match the time that you add to him.

Chairman NUSSLE. This is a hearing for the witness. If you would like to testify as a witness, we will extend the hearing and let you testify to your heart's desire. What we would like to do is get the testimony from the witness here today and move on.

The witness may respond.

Mr. BOLTEN. Thank you, Mr. Chairman. I will take only 15 seconds because I will have a further chance to address this, but I would just say, Mr. Edwards, far from creating the deficit situation that the administration found itself in as it entered into office, I believe the administration's policies brought us out of that.

The deficit that the President encountered as he was entering into office was already baked in, the result of very slow economic growth. The economic growth policy that this President and this Congress put into play is what has brought us out of that and enables us to show a declining deficit out over the next 5 years.

Thank you, Mr. Chairman.

Chairman NUSSLE. Mr. Davis.

Mr. DAVIS. Thank you, Mr. Chairman. A lot of the discussion has turned on the utility of the tax cuts and the wisdom of extending those tax cuts, and I think you have gotten the gist of the argument that has played out. People on this side of the room tend to think that the tax cuts were a bit outside.

I want to turn the conversation away from the size of the tax cuts to how the tax cuts were structured. One of the concerns that I certainly have, and I think a number of my colleagues on this side have, to an overwhelming degree the beneficiaries of these tax cuts were people at the top end of the economic sphere.

It is obvious people who pay more taxes get bigger tax cuts. I am talking about the fact that people who are mid-income wage earners, relatively low-income wage earners are still paying taxes. The amount of reduction over the last several years has been very low. I have seen data in my district, where the median income is not a high one, the average wage earner pocketed about \$36 to \$42 a month in tax relief.

What I want to explore with you is, if a different policy had been pursued, if we had had roughly the same number of tax cuts, but it shifted the benefit more toward people of the mid-income section, where we also have had a stimulative impact that you celebrate, could we have had an even greater stimulative impact?

One of the things from the business section of the “New York Times” today, headline, “How Long Can Workers Tread Water, Income Gains Go Mostly to the Affluent.” We know well before seeing this that in our economy in the last several years, wages from the service and manufacturing sectors, where most people work, have been stagnant. We know there is a greater gap between skilled workers and unskilled workers than what we had 10 years ago. And the proposition that I would want you to comment on is, if we had pursued a strategy of concentrating our tax relief more toward middle-income Americans, what would the stimulative impact have been? Can we conclude that the stimulative impact would not have been as good, or greater than what we had?

And the second question I want to pursue with you is related to that. In the budget submitted by your administration, there has been—the numbers ebb and flow a little bit, but by and large there has not been a commitment to worker training or to preparing workers to retool to do the work that is available in the wake of globalization, the work that is available in this new economy. And I am sure some in the administration would say there have been nominal increases, but I think you would agree this is an area of underinvestment in the budget and in our economy.

What if we had a much greater investment in training people to do the work, sharpening peoples’ job skills? What if we had a greater investment in K–12 education or for that matter in Perkins grants or Pell grants, all of the things that might allow the public education system in this country to move people into stronger economic footing? Would that not have a significant stimulative impact?

And the final point I want you to cover is a generic point about this whole proposition, tax cuts lead to growth which leads to more revenue. Sometimes when I hear these arguments play out, they have a little bit of the force of theology. A lot of people on the other side of the aisle believe in this so much that they don’t want to be too troubled by what the Old Testament says, but they really like the New Testament stuff, or they like the way it sounds.

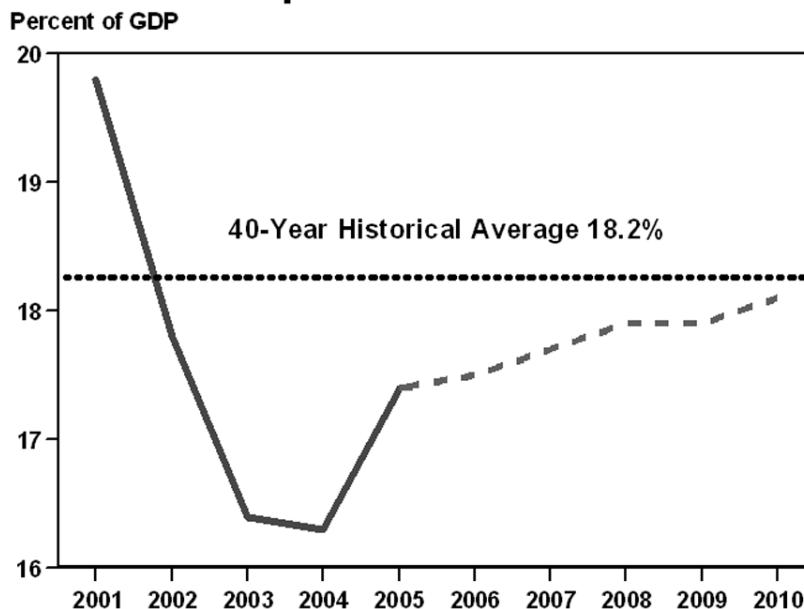
Just some basic numbers that I raised with you and Mr. Holtz-Eakin, with Secretary Snow, and with the chairman: As I understand it, you look at corporate tax receipts, and individual income tax receipts, right now they are about 16 percent of GDP. That is the lowest level we have had since World War II—around 22 percent in the 1990s, around 28 to 30 percent in the 1960s, around 25 percent in the 1980s.

Obviously, in the 1980s, 1960s, and 1990s, we had sustained significant economic growth across all economic class lines; and if this theology had a little bit more force, it would seem we ought to be having some of the greatest growth we have had since World War II, based on tax rates going down so low. Those are the three propositions I want you to comment on in 15 seconds or whatever time the Chair will give you.

Mr. BOLTEN. Thank you, Mr. Davis.

If the Chair would allow me a couple of minutes to respond on each of those. May I start with chart 9? I will take them in reverse order because I can remember the last one.

Receipts on the Rebound



This is a chart showing what percent of GDP is taken by the Federal Government in taxes. You see them dropping—the share of the GDP dropping off dramatically in the first 2 years of this administration. It might be facially attractive to some on that side to attribute that to tax cuts, but in fact there is a very little element of tax in that drop-off. It is principally related to bad economic performance.

We experienced a stock market bubble at the end of the 1990's and into 2000. With the bursting of that bubble, with the onset of recession at the beginning of 2001, Federal revenues just fell off of a cliff. This was before even the beginning implementation of any of the President's tax policies.

The point I want to make to you with this chart is, what you see with our projections is here in 2005, we are actually restored to about a 17.4 percent of GDP tax take of the economy and projecting out. Going forward with the President's tax cuts fully implemented, we project ourselves out close to the 40-year historical average of taxes being taken out of the economy.

Mr. DAVIS. But you project slower growth over that period than we have had 40 years prior to that.

Mr. BOLTEN. You mean the 5 years going forward? I think our growth is actually projected to be just about average solid growth. We are projecting between 3 and 3.5 percent GDP growth. That is consistent with Blue Chips and it is not spectacular, but it is healthy growth in the economy.

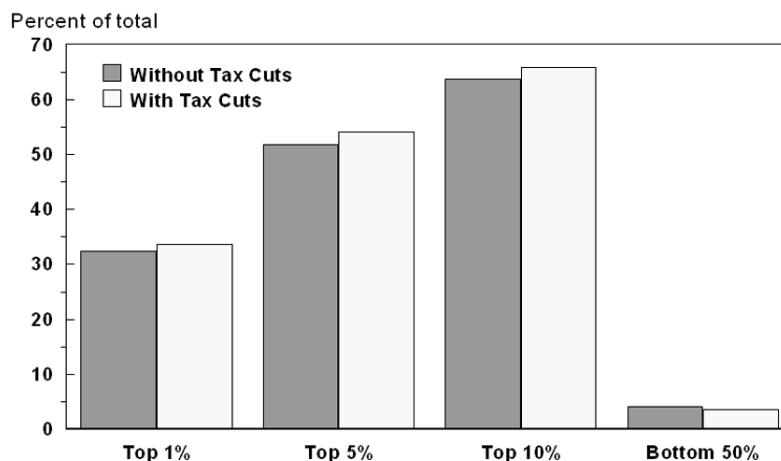
Let me turn quickly to the training point because I don't want to try the chairman's patience here.

The administration has made a strong investment in our training programs. They are indeed troubled because many of these pro-

grams are not delivering the kinds of results that they should be. Secretary Chao has been working, and will be working further, to try to ensure that our training programs are targeted to actually achieving results rather than just getting money out the door. I think she has made a number of improvements and there are more improvements on the way, but I would join in the sentiment that a well-targeted and effective training program can be very useful in preparing our citizens to participate in a strongly growing and—contributing to a strongly growing economy. So I would associate myself with that sentiment that you expressed.

Finally, on taxes, if I could have chart No. 10, I want to begin by challenging your assumption that the tax cuts that the President and this Congress put in place somehow shifted the burden of taxation away from the upper income more toward the lower income. What this chart shows, the blue bars are what would be the tax take from these earnings categories if the tax cuts had not been implemented. The yellow bars show what they are now with the full implementation of the President's tax cuts.

Projected Share of Individual Income Taxes in 2005



Source: Department of Treasury Fact Sheet, March 2, 2005

I will just take a set of bars in the middle, top 5 percent, that is, people making over \$140,000, so people doing reasonably well; in the absence of the President's tax cuts, those people would have been paying 51.7 percent of our total income tax take. After the President's tax cuts, they pay 54.1 percent of the total income tax take.

What has occurred with the President's tax cuts, although you correctly observed that if you are the one paying a lot of taxes and there is a cut, you are bound to be saving more dollars than somebody who is not paying a lot of taxes. What has occurred with the President's tax cuts is that a larger share of the burden of our income tax is now borne by our upper-income citizens than ever before. What you see on the right side there is the top 10 percent of

income earners in this country are now paying close to 66 percent of the total income tax take in this country, up from 64 percent.

So the economists can have arguments about what kind of tax cut is the most stimulative. I think most economists will tell you, depending on the situation, the one that produces the most economic growth may be the one that is targeted toward the very top rate, the very top marginal rate is the most effective thing to do. They may tell you that a cut in the capital gains tax or the dividend tax has been most effective in spurring business, investment and growth. Regardless of what the result of that argument is, the result of the President's tax cuts has been that the wealthy bear a greater share of our income tax burden than they did in the past.

Mr. DAVIS. I will try to keep it inside 10 seconds.

My concern, Mr. Bolten, is not so much the relative share, but the fact that the bottom line is that we have had slow wage growth. We have had rising tuition in a lot of States. We have had rising State income taxes. We have had rising prices. People are concerned about food and gasoline. And I would like to see some policy.

Because, frankly, we have not had a sustained round of significant tax cuts for people earning under \$80,000 in the last 30 years in this economy; and if we were so fixated on getting stimulation out of our tax cuts, I would want to see us move in that direction.

Chairman NUSSLE. Ms. Schwartz.

Ms. SCHWARTZ. Thank you, Mr. Chairman. I appreciate it.

What I wanted to ask, specifically, is about the interest payments that we are making on the debt. And I appreciate what was said already about the fact that we are seeing a smaller deficit being created this year than in the past. That doesn't say that we—as the chairman said in his opening remarks, rather large—he said, large deficits in the near term. I want to talk about what that means to the American people and the people in my district, who are not aware of how much money is going into interest payments by our Government.

And just to reflect on it for a moment, we passed a bankruptcy law not too long ago in Congress that the President signed quite enthusiastically, and we actually did that, calling on individual families to take personal responsibility for their finances. But I think it is very important for the American people to say we may not be doing all that we could on the Federal level and acting responsibly in the way we create these budgets.

And it is not just what we say, but what we do and what is reflected in these many charts. But basically the spending plan has to reflect basic budgetary principles. We have to meet our obligations. We have to work within the resources we have. And we have to make smart investments that will ensure the well-being of our Nation now and into the future.

And just answer this “yes” or “no,” if you would: Isn't it true that the Federal Government is spending more on interest payments on the debt that we have—more than we are spending on education, veterans' health care or the environment?

Mr. BOLTEN. Ms. Schwartz, I don't know whether it is true or not. It may be true.

Ms. SCHWARTZ. I will give you some numbers and I am sure your team could help you. In 2004, the Government spent \$160 billion on interest payments, more than double the appropriations for education, training, and social services, which was \$78 billion; five times more than the amount spent on the environment, which was \$31 million; five times more than we spent on veterans' health care which was \$29 billion.

By the year 2010, under the current administration's policies, we will be paying \$312 billion in interest payments, 4 times greater than Federal funding for education, over 10 times more than projected spending on the environment, and more than 10 times more than expected on veterans.

That is stunning to me as a new Member of Congress that we are spending those sums of money.

So while we may be proud that we have less of a deficit this year than previous years, we do have this enormous debt in this country that is costing us a great deal, and it is freezing out our ability to make the kind of investments that we need to in Americans, in education, in health care, and in the environment and some of the economic stimulus that will help us now and into the future.

How do we get out of this box is what I would ask you about, given that you have said that we are actually pretty optimistic about things? The American people have to understand, the priority of this administration is really much more on paying this interest payment than getting our fiscal house in order.

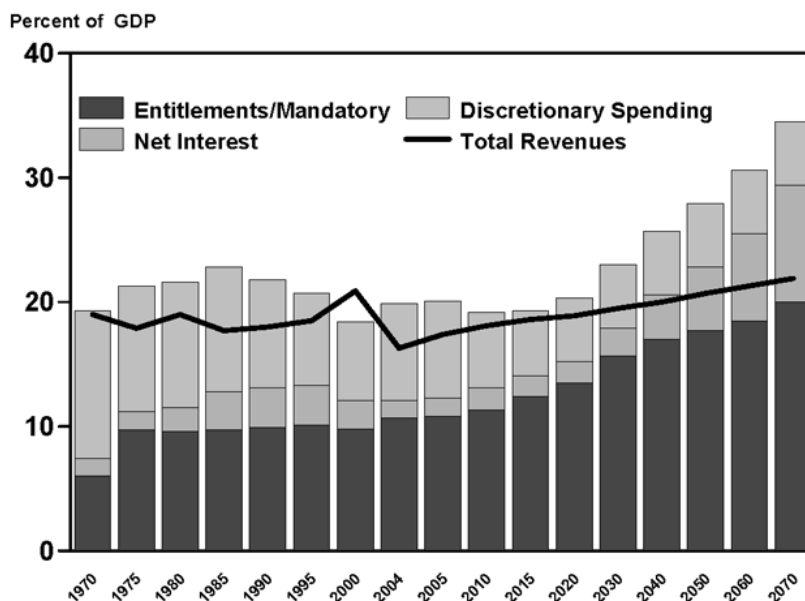
Mr. BOLTEN. Ms. Schwartz, I have to say I agree wholeheartedly with a lot of what you just said, and the priority for this administration is in fact on ensuring that there is growth in the economy. This is what people really need to prosper themselves, and to restrain spending, the combination of which brings us into some sort of fiscal balance.

Let me put up chart 22, if I may, and just talk a little bit about that, because in celebrating the good news today, I had intended to be clear—and I know the chairman was clear in his opening remarks—in indicating that it is an improvement over where we have been, and I believe a strong vindication of the policies we have been pursuing.

Does that mean it is time to ring the dinner bell? Absolutely not.

What this chart shows is that as you look out into the future and as we plan our budgets, we need to be cognizant of where we are taking the situation in the future. You will see that the part that is growing enormously as a percent of GDP is the dark blue part, the entitlements and our mandatory programs. The green part, the interest payments of the Federal Government, are the obligations that we have to pay. There is no option about that. If there is a debt, you have to pay it.

Current Trends Are Not Sustainable



Ms. SCHWARTZ. Unless we are doing well enough to pay down principal. That is what we ask people to do, as well.

Mr. BOLTEN. That is the administration's objective, and we have urged a variety of measures of spending restraint. I don't believe you can get there by tax increases that will harm the economy and make it more difficult.

Ms. SCHWARTZ. In my remarks, I didn't make that suggestion.

Mr. BOLTEN. Some of your colleagues have. If that is not the right way to go, then the right way to go is spending restraint, which the President has indicated in his budgets, and the House of Representatives has indicated in its appropriations it is willing to accept.

The reason I put this chart up is that spending restraint in appropriations is only a part of the story for making us look good out over the next 5 or 10 years, which is the budget window I have been reporting on.

The budget window beyond that is not favorable at all, and it is reflected by the enormous growth in that blue area. Because that blue area grew so much, the green area grows correspondingly as well. It is the enormous unfunded liability in our entitlement programs that really threatens our fiscal situation and makes it very difficult for us to plan to try to pay down any of the interest. On the contrary, it means that interest itself could contribute to overwhelming the ability of our resources to pay for our debts.

What that says is, in addition to continuing progrowth policies and exercising restraint with our appropriated spending, we need to pursue fundamental reform in our entitlement programs. I believe this President has stepped forward in a major way with his

Social Security plans. We also need to look at the Medicare and Medicaid systems as well.

Chairman NUSSLE. I thank the gentlelady. I recognize myself now for my question time, just to say a couple of things. One is, I think this is a great way to end. The gentlelady and our witness today have kind of brought us to the threshold of the next big project that our committee is going to undertake together, with obviously the other committees of Congress, and that is called reconciliation.

It is a huge project, and it was in large measure the blue area that was being discussed in your testimony, and it is the hardest area to control.

The most difficult votes and some of the biggest challenges are coming. I have checked my schedule, and I didn't see any celebration on my schedule today. I am not celebrating, but I am optimistic. When I see that real GDP has increased for 14 consecutive months, that gives me some optimism about America. With the strongest growth in 5 years, that gives me optimism. When I hear we have created 3.7 million jobs in the last 25 months, that gives me optimism, that doesn't make me frown.

There has been a lot of frowning around here today. And I understand there are challenges out there and no one has scheduled a celebration. However, we should be optimistic about the fact that we have an unemployment rate that has fallen from 6.3 percent 2 years ago to 5 percent now, meaning that 95 percent of Americans who are out there and want a job—and I remember back to my college days what the definition of full employment was, that is pretty darn close to full employment from the old textbook models of what full employment is all about, where the other 5 percent are in school or looking for work or in transition.

Total employment at record highs; 141 million people are working. In fact, my son is one of them, he just got his first job as a teenager. Growth in the business equipment investment is the best in 6 years, and home ownership rates are at record highs. The gentleman who spoke earlier about people who are particularly at middle income and lower income, and owning a home is a gigantic part of being self-sufficient and being secure. And then, as I said in my opening, you don't have to believe us here today. You can look to what the private forecasters are saying, and they expect this kind of growth to continue. That makes me optimistic.

I understand we have work to do. I was the first one to say it, I will be the last one to say it, I have no doubt. But I also know that we will be joined in this effort by a number of other committees as we try and do the spade work this year with the reconciliation process to get that under control. It is about reform, not just reduction in spending, but reforming it to deliver a better quality product to the people we are trying to serve.

This committee is leading that effort, and I am proud of the leadership and I am proud of the leadership the President has made.

You have been very generous with your time here today, as well as in your delivery and how calm you have been; and I—do you have a celebration on your schedule today? Maybe you deserve one, but we do appreciate your coming up and spending time with us, and we look forward to that opportunity again in the near future.

Mr. BOLTEN. Mr. Chairman, I thank you and Mr. Spratt and all the members for their courtesy.

Chairman NUSSLE. If there is nothing else to come before the committee, without objection, we will stand adjourned.

[Whereupon, at 1:05 p.m., the committee was adjourned.]

