THE CONGRESSIONAL BUDGET OFFICE'S BUDGET AND ECONOMIC OUTLOOK

HEARING

BEFORE THE

COMMITTEE ON THE BUDGET
HOUSE OF REPRESENTATIVES

ONE HUNDRED TENTH CONGRESS

FIRST SESSION

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THE CONGRESSIONAL BUDGET OFFICE'S BUDGET AND ECONOMIC OUTLOOK

TUESDAY, JANUARY 30, 2007

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

The committee met, pursuant to call, at 10:03 a.m., in room 210, Cannon House Office Building, Hon. John M. Spratt, Jr. (Chairman of the committee) presiding.

Present: Representatives Spratt, DeLauro, Edwards, Cooper, Allen, Becerra, Doggett, Blumenauer, Berry, McGovern, Sutton, Scott, Etheridge, Hooley, Baird, Moore, Bishop, Barrett, Bonner, Garrett, Diaz-Balart, Hensarling, Lungren, Simpson, McHenry, Conaway, Campbell, Porter and Smith.

Chairman SPRATT. I call the meeting to order and open the hearing with a congratulations again to Dr. Peter Orszag, our witness this morning, on his appointment as the Director of the Congressional Budget Office. He is a superbly qualified economist. He has an outstanding reputation not just among economists, but among the public and Members of Congress alike.

We are pleased to have you, Peter, as the Director of the CBO and as a central part of the budget process as we face the challenges, and there are plenty, that lie ahead of us.

The purpose of today's hearing is to discuss CBO's newly released budget and economic outlook, and to give Members an opportunity to ask Dr. Orszag about CBO's estimates. CBO does excellent work in producing its budget estimates and forecasts. It is also important for Members to understand and for the general public to understand that the restrictions or conventions that are imposed upon CBO by law and by practice make their estimates and the subsequent limitations of the baseline subject to explanation because they are not to be taken as predictions so much as they are benchmarks where we are with respect to current policy.

Any improvement in the deficit is a welcome development. Last week's baseline budget estimate from CBO is still not any cause for declaring victory. When the surplus from Social Security is excluded, as I think it should be, the deficit for this year's budget is $362 billion, and it hovers in this range until 2011. At that point budget forecasting rules call for CBO to assume that the tax cuts passed in 2001 and 2003 will expire as the terms provide. The Bush administration assumes otherwise, and the consequences for the bottom line are going to be enormous.

CBO is also required to assume that the alternative minimum tax will remain enforced and not be adjusted so that the AMT be-comes a tax schedule for tens of millions of American taxpayers, most of for whom it was not intended. If instead the AMT is fixed so that it applies only to up-bracket taxpayers, those for whom it was originally intended, the loss revenues between 2008 and 2017 is in the range of a trillion dollars.

On the spending side, budget forecasting rules call for CBO to assume that the supplemental appropriation passed in the previous year carried forward to future years. Since the fiscal year 2007 Defense Appropriations Act includes $70 billion for bridge funding for operations in Iraq and Afghanistan, this level of expenditure is included or assumed in the 2008, 2009 and through 2017. With the supplementals for Iraq and Afghanistan totaling $120 billion in 2006, probably as much as $170 billion in 2007, the $70 billion carried forward is a likely understatement, at least for the short run.

When these adjustments are made, the estimates from CBO become a sobering reminder of how much current policy will have to be changed to return the budget to a fiscally responsible course. If not corrected, large deficits—these large deficits will result in a rising mound of debt, which CBO already estimates to total $8.9 trillion by the end of this year. This means there has been a 55 percent increase in the statutory debt since the Bush administration took office, and its corresponding increase in debt service means that—and a corresponding increase in debt service.

So the challenges we face are considerable. When you open this book, Dr. Orszag, and read the first paragraph in the first chapter, this sounds like good news. Congressional Budget Office projects that if current laws and current policies remain the same, the Federal budget will assure a deficit of $172 billion for the year 2007. That is good news, no question about it. But if you turn the page and read the first paragraph on page 2, CBO tells us, however, if all tax provisions set to expire over the next 10 years were extended, and the AMT is indexed for inflation, the budget outlook for 2017, 10 years from now, would change from a surplus of $249 billion, a surplus, to a deficit of $476 billion. Debt held by the public at the end of 2017 would climb to nearly 40 percent of GDP, and the 10-year cumulative deficit total would be $3.2 trillion. In other words, we have our work cut out for us.

Dr. Orszag, I welcome you here, but before turning to you to hear your statement, let me offer the Ranking Member Mr. Ryan the opportunity to make an statement as well. Mr. Ryan.

Mr. RYAN. Thank you, Mr. Chairman. Excuse me while I cough while I do my opening remarks. When you have a 2-, 3-, and 4-year-old, you get a cold about every 2, 3 or 4 weeks.

The budget outlook we are considering today—first of all, I want to welcome Dr. Orszag. It is good to have him, off to a good start, and this is a very, very good read as far as CBO outlooks go.

The outlook we are considering today does contain some truly good news. Even as we have kept tax burdens low, revenues have continued pouring into the Treasury at higher-than-expected revenues, and this is the single biggest factor in this current year's deficit reduction. But the good news basically does stop right there.

As Chairman Spratt just noted, and as Dr. Orszag will confirm, I have no doubt, much of the budget outlook rests on unrealistic assumptions both on the spending side and on the tax side. Among them clearly are the funding levels for the war in Iraq and significant tax increases. But even taking these facts in account tends to obscure the most important driver of Federal spending, and the biggest threat to our fiscal and economic health; that is, entitlement spending.

Just a week ago we heard from David Walker, the Comptroller General, and others that warned us that unless Congress takes prompt, substantive action to address the unsustainable growth in entitlement programs, particularly our large health care programs, both the budget and the economy will face serious consequences.

CBO's report echoes these concerns. It projects entitlement spending to grow about 5.9 percent a year. This trend will be led by Medicare and Medicaid, which will grow at about 7 to 8 percent a year. Even if we allow all the tax cuts to expire, it is swamped by this growth in entitlement spending. So even if we manage to balance the budget by 2012, which I think we can and should do, entitlements will quickly drive us right back into deficit, and the situation will keep getting worse after that.

So we see good news now. It is kind of a calm before the storm. And let's just put it into perspective and realize that we have a big storm coming on the horizon. So the point is that it is not enough for us in Congress to only look at war costs or discretionary spending or whether taxes are permanent or not; we need to face up to the entitlement problem, and we need to do it soon.

Again, there was some truly good news in the report and I don't want to lose sight of that. The economy is growing well. Inflation is in check. A lot of good things are happening. We have had 7.2 million jobs created since the last recession, but we can't use this report to bury our heads in the sand, and we cannot pretend that simply cutting defense spending or raising taxes is going to solve the real problem we face. We can get to balance in 5 years, and I believe we should, and I think we will. But we cannot do it with massive tax hikes. I believe Dr. Orszag will agree that we are going to have to make difficult decisions and enact substantive changes to address the growth in entitlement spending, and we are going to have to do it soon if we are going to do it right. Thank you.

Chairman SPRATT. Thank you, Mr. Ryan.

[The prepared statement of Mr. Ryan follows:]

PREPARED STATEMENT OF HON. PAUL RYAN, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF WISCONSIN

The budget outlook we are considering today does contain some truly good news. Even as we've kept tax burdens low, revenue has continued pouring into the Treasury at higher-than-expected levels. And this is the single biggest factor in the current year's deficit reduction.

But the good news stops there. As Chairman Spratt has noted—and as Director Orszag will confirm—much of the budget outlook rests on unrealistic assumptions—both on the spending and tax side. Among them, clearly, are funding levels for the war in Iraq, and significant tax increases.

But even taking these facts into account tends to obscure the most important driver of federal spending, and the biggest threat to our fiscal and economic health: entitlement spending.

Just a week ago today, this Committee heard compelling testimony from the Comptroller General, David Walker, and others warning us that unless Congress takes prompt, substantive action to address the unsustainable growth in entitlement spending—particularly of our largest healthcare programs—both the budget and the economy will face serious consequences.

CBO's report echoes these concerns. It notes that entitlement spending—which already consumes more than half of the budget—is projected to grow at about 5.9 per year.

This trend will be led by Medicare and Medicaid, which will grow at 7 to 8 per year—faster than projected growth of the entire economy, and faster than projected growth in tax revenue—even if the 2001 and 2003 tax relief was allowed to expire.

So even if we could manage a balanced budget by 2012, entitlements would quickly drive us right back into deficit, and the situation would just keep getting worse after that.

The point is that it's not enough for us in Congress to look only at war costs, or discretionary spending, or taxes. We need to face up to the entitlement problem—and we need to do it soon.

Again, there was some truly good news in this report, and I don't want to lose sight of that.

But we can't use this report to bury our heads in the sand, and we can't pretend that simply cutting defense spending or raising taxes is going to solve the real problem we face.

We can get to balance in five years—and we can do it without massive tax hikes.

But—as I believe Dr. Orszag will agree—we're going to have to make difficult decisions, and enact substantive changes to address the growth of entitlement spending, and we're going to have to do it soon.

Chairman SPRATT. Dr. Orszag, you can submit your statement for the record, which will be acceptable from you, and I think you are our only witness today. Summarize as you please, but the floor is yours. Go ahead. We are glad to have you.

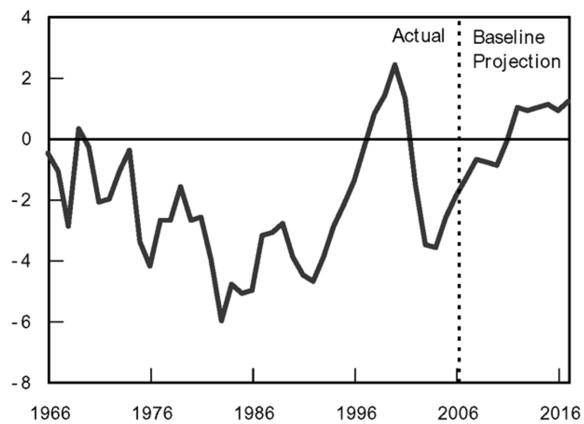
STATEMENT OF PETER R. ORSZAG, DIRECTOR, CONGRESSIONAL BUDGET OFFICE

Mr. ORSZAG. Thank you very much, Mr. Chairman and Mr. Ryan and other members of the committee. I am looking forward to working with all of you over the next 4 years as we struggle with the Nation's fiscal challenges. I will try to be quite brief in my opening remarks to leave plenty of time for questions, especially since Chairman Spratt and Mr. Ryan covered many of the points I was intending to cover, thus making it easier for me.

I have five points to make about the economic and budget outlook, and I think interpreting the document that we released requires taking all five points into account.

The first point is that under the official baseline, which, as Chairman Spratt noted, reflects current law with regard to revenue and spending, the budget deficit falls from $248 billion last year to $172 billion this year. That excludes any outlays associated with a likely supplemental appropriation for the ongoing war on terrorism. Including that spending would bring the deficit for 2007 up to a figure of around $200 billion or so.

The Total Deficit or Surplus as a Percentage of Gross Domestic Product, 1966 to 2017



Over the next 10 years, as the first chart shows, if the first chart comes up, the budget under the baseline moves into surplus in 2012 and then remains in surplus through the rest of the budget window. That very significant increase around 2012, which is that sharp upward movement in the line there, is associated with the expiration of various revenue provisions at the end of 2010, which raises revenue in 2011 and thereafter.

Effects on the Deficit or Surplus from Selected Policy Alternatives Not Included in CBO's Baseline

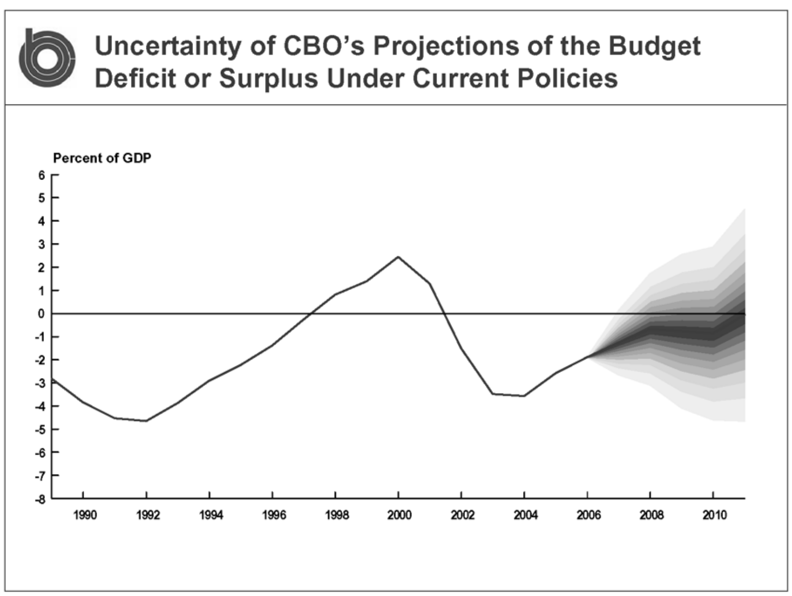
(Billions of dollars)

	2012	2008-2017
Increase Discretionary Appropriations at Rate of Growth of Nominal GDP	-122	-1,487
Extend EGTRRA and JGTRRA	-267	-2,250
Index the AMT for Inflation	-48	-724
Interactive Effect of Extending EGTRRA and JGTRRA and Indexing the AMT	-61	-542
Note: Baseline Balance	170	800

My second point is, as has already been noted by both Chairman Spratt and Mr. Ryan, that baseline adopts a specific set of assumptions for the future. In particular, it strictly interprets current law. So various revenue provisions that are scheduled to expire or are soon to expire, discretionary spending is assumed to keep pace with inflation, but not with population growth or with overall economic growth. As a result of those two assumptions, revenue rises from 18.6 percent of the economy this year to over 20 percent by the end of the projection window. That is largely because the alternative minimum tax grows significantly from 4 million taxpayers last year to 33 million in 2010, and because of the expiration of various revenue provisions associated with the 2001 and 2003 tax legislation, and discretionary spending falls from 7.8 percent of the economy to 5.8 percent of the economy by the end of the budget window.

If you made an alternative set of assumptions about the course of future policy and, for example, assume that discretionary spending, including the war on terrorism, kept pace with the overall economic growth, and that the 2001 and 2003 tax provisions were not allowed to expire, and that the alternative minimum tax was not allowed to overtake the tax system, instead of a surplus in 2012 of $170 billion dollars, one would have a deficit of $328 billion, and over the 10-year window you would have a cumulative deficit of $4.2 trillion.

So again, it has already been noted, making different assumptions, I think the next slide summarizes those, and those are inclusive of the debt service implications of changing policy. Changing policy relative to current law has a significant effect on budgetary outcomes.



My third point, if we could go to the next slide, has to do with uncertainty. I think it is very important to realize this year we are expected to spend about $2.7 trillion. We are expected to bring in revenue of about $2.5 trillion for a deficit of about $200 billion. If we are 5 percent too high on spending and 5 percent too low on the revenue projection, so just 5 percent on each, the actual outcome would shift from a deficit of $200 billion to a surplus of more than $50 billion, the point being that being slightly off on two big numbers can have a very big effect on the difference between those two numbers, which is the deficit. So there can be very substantial swings in the deficit from relatively minor errors in forecasting big numbers like revenue and spending.

To try to illustrate that uncertainty, this chart shows you the projected budget outcomes under the baseline, with the dark blue area representing the most likely outcomes under that baseline. For example, in 2010, we project a deficit of about 1 percent of GDP of the economy, but there is a 20 percent probability based on past forecasting errors of a 3 percent deficit or larger, and a 5 percent probability of a 3 percent surplus or more. So I want to make sure that everyone understands that there is significant uncertainty surrounding future budgetary outcomes.

Effect on the Cumulative Deficit from Changes in CBO's Baseline Projections Since August 2006

(Billions of dollars)

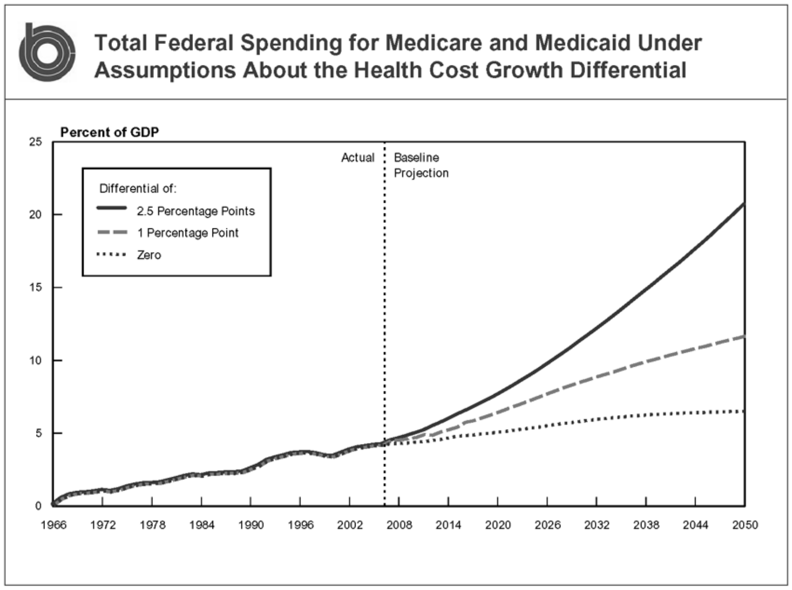
	2007-2016
Total Deficit as Projected in August 2006	-1,761
Legislative Changes	
Revenues	-42
Outlays	*1,212*
Economic Changes	-173
Technical Changes	
Revenues	300
Outlays	*842*
Total Effect on the Deficit	2,140
Total Surplus as Projected in January 2007	378

The fourth point has to do with the changes since last August. If we could go to the next slide, please. Thank you. Consistent with the emergence of projected surpluses under the baseline, which did not occur last August, there has been a significant improvement in the baseline since last August. Last August, for 2007 through 2016 we were projecting a deficit of $1.8 trillion. We are now projecting a surplus over that period of almost $400 billion.

But I want to quickly make two points about that improvement. First, it has little to do with changes in economic assumptions. In fact, economic changes by themselves account for only $173 billion of that shift. Secondly, a very large chunk of it, roughly half, has to do with the mechanical implications of our assumptions with regard to discretionary spending. By scoring convention, what we do is we take enacted appropriations in the base year and project them out. In August, that base year included $120 billion in appropriations for the global war on terrorism, and a little bit less than $60 billion for domestic relief activities associated primarily with the hurricane. This year so far we only have $70 billion enacted with regard to the global war on terrorism, and nothing corresponding to the domestic relief activity. So in both categories there is basically about $50 billion less in the base year, and then project that forward in each year thereafter and you get about $500 billion less in defense spending and $500 billion less in nondefense spending, which has little to do with the underlying fiscal environment, and it is instead mostly mechanical implication of the way that we are instructed to conduct or to construct the baseline.

The other point, though, is that there is some real improvement, as Mr. Ryan noted, in the short term. Some of that has to do with improved outlay projections over the longer term, over the 10-year period as a whole. Much less of the improvement has to do with revenue. In fact, the net effect on revenue changes since August 2006 is only $57 billion over the 10-year window.

The real improvement, abstracting from that mechanical discretionary assumption, has to do with Medicare spending in particular. We have $445 billion less in Medicare spending over the 10-year window than in August 2006, of which $265 billion comes from Medicare Part D, the prescription drug benefit. That in turn reflects both lower cost per beneficiary—bids came in 15 percent lower than last year this year—and also a lower outyear assumption with the regard to the number of beneficiaries who will take up the benefit, because now we have more information—we have real information on beneficiaries. It looks like a larger share of beneficiaries will have other coverage and, therefore, not take up the Medicare benefit in the outyears. Both of those combined reduced the Part D projections by $265 billion.



My final point—and this returns to a theme that Mr. Ryan noted also—if we could go to the final chart, please—is that over the long term, the Nation's fiscal imbalance is quite serious. It has a lot to do especially with our health care programs. Medicare and Medicaid combined, the Federal share of Medicaid plus Medicare, amount to 4½ percent of GDP this year. They are projected to rise to 5.9 percent by the end of the budget window in 2017. If over the next 40 years health care costs continue to grow as rapidly relative to economic growth as they did over the past 40 years, one gets that top line shown in this graph. Medicare and Medicaid would amount to 20 percent of the economy by 2050 under that projection. That is as large as the entire Federal share today. Even if health care costs' growth slow to 1 percent faster than economic growth, which is the dotted line in the middle, those two programs would have accounted for 10 percent of the economy.

It is not too gross of an exaggeration to say the central long-term fiscal challenge facing the United States is to bend that curve so that cost growth occurs at a slower rate, and I would say there is a significant opportunity for us to slow health care costs without impairing innovation and without harming Americans' health if we can find better ways of making sure that our health care system is cost-effective.

But in light of that curve in particular, it is implausible that economic growth alone will eliminate our long-term fiscal imbalance, and some combination of spending reductions and/or revenue increases will be necessary to avoid a very significant fiscal problem that will develop over the medium to long term. Thank you very much.

[The prepared statement of Peter R. Orszag follows:]

PREPARED STATEMENT OF PETER R. ORSZAG, DIRECTOR, CONGRESSIONAL BUDGET OFFICE

Chairman Spratt, Congressman Ryan, and Members of the Committee, thank you for giving me this opportunity to present the Congressional Budget Office's (CBO's) budget and economic outlook for fiscal years 2008 to 2017.[1]

If current laws and policies remained the same, the budget deficit would equal roughly 1 percent of gross domestic product (GDP) each fiscal year from 2007 to 2010, the Congressional Budget Office (CBO) projects. Those deficits would be smaller than last year's budgetary shortfall, which equaled 1.9 percent of GDP (see Table 1). Under the assumptions that govern CBO's baseline projections, the budget would essentially be balanced in 2011 and then would show surpluses of about 1 percent of GDP each year through 2017 (the end of the current 10-year projection period).

The favorable outlook suggested by those 10-year projections, however, does not indicate a substantial change in the nation's long-term budgetary challenges. The aging of the population and continuing increases in health care costs are expected to put considerable pressure on the budget in coming decades. Economic growth alone is unlikely to be sufficient to alleviate that pressure as Medicare, Medicaid, and (to a lesser extent) Social Security require ever greater resources under current law. Either a substantial reduction in the growth of spending, a significant increase in tax revenues relative to the size of the economy, or some combination of spending and revenue changes will be necessary to promote the nation's long-term fiscal stability.[2]

CBO's baseline budget projections for the next 10 years, moreover, are not a forecast of future outcomes; rather, they are a benchmark that lawmakers and others can use to assess the potential impact of future policy decisions. The deficits and surpluses in the current baseline are predicated on two key projections (which stem from longstanding procedures that were, until recently, specified in law).[3]

- Revenues are projected to rise from 18.6 percent of GDP this year to almost 20 percent of GDP in 2012 and then remain near that historically high level through 2017. Much of that increase results from two aspects of current law that have been subject to recent policy changes: the growing impact of the alternative minimum tax (AMT) and, even more significantly, various provisions originally enacted in the Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA) and the Jobs and Growth Tax Relief Reconciliation Act of 2003 (JGTRRA) and modified by subsequent legislation, which are scheduled to expire by December 31, 2010.
- Outlays for discretionary programs (activities whose spending levels are set anew each year through appropriation acts) are projected to decline from 7.8 percent of GDP last year to 5.8 percent of GDP by 2017—a lower percentage than any recorded in the past 45 years. That projection derives mainly from the assumption in the baseline that discretionary funding will grow at the rate of inflation, which is lower than the growth rate that CBO projects for nominal GDP. The projection for discretionary spending implicitly assumes that no additional funding is provided for the war in Iraq in 2007 and that future appropriations for activities related to the war on terrorism remain equivalent, in real (inflation-adjusted) terms, to the $70 billion appropriated so far this year.

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[1] See Congressional Budget Office, The Budget and Economic Outlook: Fiscal Years 2008 to 2017 (January 2007).

[2] For a detailed discussion of the long-term pressures facing the federal budget, see Congressional Budget Office, The Long-Term Budget Outlook (December 2005), Updated Long-Term Projections for Social Security (June 2006), and The Outlook for Social Security (June 2004).

[3] The Balanced Budget and Emergency Deficit Control Act of 1985, which established rules that govern the calculation of CBO's baseline, expired on September 30, 2006. Nevertheless, CBO continues to prepare baselines according to the methodology prescribed in that law.

SUMMARY TABLE 1.—CBO'S BASELINE BUDGET OUTLOOK

	Actual 2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	Total 2008–2012	Total 2008–2017
	IN BILLIONS OF DOLLARS													
Total Revenues	2,407	2,542	2,720	2,809	2,901	3,167	3,404	3,550	3,717	3,896	4,084	4,284	15,001	34,531
Total Outlays	2,654	2,714	2,818	2,926	3,038	3,179	3,234	3,391	3,533	3,687	3,892	4,034	15,194	33,731
Total Deficit (−) or Surplus	−248	−172	−98	−116	−137	−12	170	159	185	208	192	249	−194	800
On-budget	−434	−357	−299	−332	−367	−258	−85	−101	−79	−57	−72	−10	−1,342	−1,662
Off-budget[a]	186	185	201	216	230	246	255	261	264	265	264	259	1,148	2,461
Debt Held by the Public at the End of the Year	4,829	4,995	5,104	5,232	5,380	5,403	5,242	5,089	4,912	4,709	4,521	4,274	n.a.	n.a.
	AS A PERCENTAGE OF GROSS DOMESTIC PRODUCT													
Total Revenues	18.4	18.6	19.0	18.7	18.4	19.2	19.8	19.8	19.8	19.9	20.0	20.1	19.1	19.5
Total Outlays	20.3	19.9	19.7	19.5	19.3	19.3	18.8	18.9	18.8	18.8	19.1	18.9	19.3	19.1
Total Deficit (−) or Surplus	−1.9	−1.3	−0.7	−0.8	−0.9	−0.1	1.0	0.9	1.0	1.1	0.9	1.2	−0.2	0.5
Debt Held by the Public at the End of the Year	37.0	36.6	35.7	34.8	34.2	32.8	30.5	28.3	26.2	24.0	22.1	20.1	n.a.	n.a.
Memorandum:														
Gross Domestic Product (Billions of dollars)	13,066	13,645	14,300	15,014	15,742	16,465	17,205	17,973	18,764	19,582	20,425	21,295	78,726	176,766

Source: Congessional Budget Office.

Note: n.a. = not applicable.

[a] Off-budget surpluses comprise surpluses in the Social Security trust funds as well as the net cash flow of the Postal Service.

Policy choices that differed from the assumptions in the baseline would produce different budgetary outcomes. For example, if lawmakers continued to provide relief from the AMT (as they have done on a short-term basis for the past several years) and if the provisions of EGTRRA and JGTRRA that are scheduled to expire were instead extended, total revenues would be almost $3 trillion lower over the next 10 years than CBO now projects. Similarly, if discretionary spending (other than for military operations in Iraq and Afghanistan) grew at the rate of nominal GDP over the next 10 years, total discretionary outlays during that period would be nearly $1.3 trillion higher than in the baseline. Combined, those policy changes—and associated debt-service costs—would produce a deficit of $328 billion (1.9 percent of GDP) in 2012 and a cumulative deficit over the 2008-2017 period of $4.2 trillion (2.4 percent of GDP).

Underlying CBO's baseline projections is a forecast that U.S. economic growth will slow in calendar year 2007 but pick up in 2008. Specifically, CBO anticipates that GDP will grow by 2.3 percent in real terms in 2007, a full percentage point less than the growth recorded last year. For 2008, CBO forecasts that GDP growth will rebound to 3.0 percent. Under the assumptions of the baseline, real GDP growth would continue at a similar rate in 2009 and 2010 and then slow to 2.7 percent in 2011 and 2012. For the rest of the projection period, average growth of real GDP is projected to decrease to 2.5 percent per year as increases in the size of the workforce continue to slow.

THE BUDGET OUTLOOK

CBO estimates that if today's laws and policies did not change, federal spending would total $2.7 trillion in 2007 and revenues would total $2.5 trillion, resulting in a budget deficit of $172 billion. The additional funding that is likely to be needed to finance military operations in Iraq and Afghanistan would put that deficit in the vicinity of $200 billion. Even so, this year's shortfall would be smaller than the 2006 deficit of $248 billion.

BASELINE PROJECTIONS FOR THE 2008–2017 PERIOD

Under current laws and policies, the deficit would drop further in 2008, to $98 billion. That decrease results primarily from two factors. On the revenue side of the budget, receipts from the AMT are estimated to increase by about $60 billion next year because of the scheduled expiration of the relief provided through tax year 2006. (In addition, telephone-tax refunds, which totaled $13 billion in 2007, are projected to drop by $10 billion in 2008.) On the spending side of the budget, outlays for operations in Iraq and Afghanistan and for relief and recovery from hurricane damage are about $14 billion lower in 2008 than in 2007 under the assumptions of the baseline.

The baseline deficit is projected to rise modestly over the following two years, 2009 and 2010, as outlays grow by about 3.8 percent annually and revenues increase by about 3.3 percent a year. That projected growth rate for revenues is lower than in recent years, mainly because corporate profits and capital gains realizations are expected to revert to levels that are more consistent with their historical relationship to GDP.

After 2010, spending related to the aging of the baby-boom generation will begin to raise the growth rate of total outlays. The baby boomers will start becoming eligible for Social Security retirement benefits in 2008, when the first members of that generation turn 62. As a result, the annual growth rate of Social Security spending is expected to increase from about 4.5 percent in 2008 to 6.5 percent by 2017.

In addition, because the cost of health care is likely to continue rising rapidly, spending for Medicare and Medicaid is projected to grow even faster—in the range of 7 percent to 8 percent annually. Total outlays for those two health care programs are projected to more than double by 2017, increasing by 124 percent, while nominal GDP is projected to grow only half as much, by 63 percent (see Figure 1). Consequently, under the assumptions of CBO's baseline, spending for Medicare, Medicaid, and Social Security will together equal nearly 11 percent of GDP in 2017, compared with a little less than 9 percent this year.

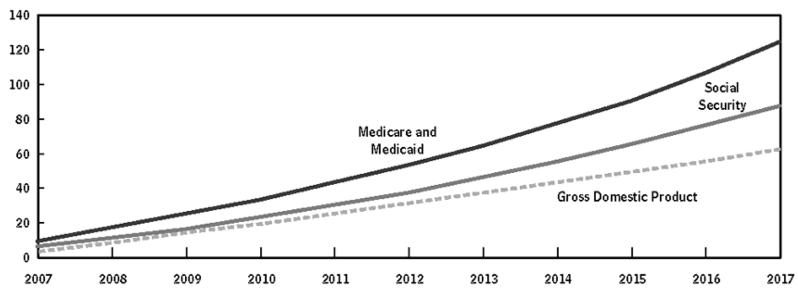
Revenues are projected to increase sharply after 2010 given the assumption that various tax provisions expire as scheduled. In the baseline, total revenues grow by 9.2 percent in 2011 and by 7.5 percent in 2012, thereby bringing the budget into surplus. Beyond 2012, revenues are projected to grow at about the same pace as outlays (by roughly 4.5 percent a year), keeping the budget in the black through 2017 under baseline assumptions.

Relative to the size of the economy, outlays are projected to range between 18.8 percent and 19.7 percent of GDP during the 2008-2017 period under the assumptions of CBO's baseline—lower than the 20.6 percent average of the past 40 years (see Figure 2). Mandatory spending (funding determined by laws other than annual appropriation acts) is projected to grow by 5.9 percent a year over that period, which is faster than the economy as a whole. By contrast, discretionary appropriations are assumed simply to keep pace with inflation and, to a lesser extent, with the growth of wages. Thus, discretionary outlays are projected to increase by about 2.0 percent a year, on average, or less than half as fast as nominal GDP.

Figure 1.

Projected Growth of the U.S. Economy and Federal Spending for Major Mandatory Programs

(Cumulative nominal percentage growth from 2006 level)



Source: Congressional Budget Office.

CBO projects that revenues will average 18.7 percent of GDP from 2008 to 2010 (close to the 18.6 percent level expected for this year) before jumping sharply in 2011 and 2012 with the expiration of tax provisions originally enacted in EGTRRA and JGTRRA. After that, revenues are projected to continue growing faster than the overall economy for three reasons: the progressive structure of the tax code combined with increases in total real income, withdrawals of retirement savings as the population ages, and the fact that the AMT is not indexed for inflation. Under the assumptions of the baseline, CBO projects that revenues will equal 20.1 percent of GDP by 2017—a level reached only once since World War II.

Federal government debt that is held by the public (mainly in the form of Treasury securities sold directly in the capital markets) is expected to equal almost 37 percent of GDP at the end of this year. Thereafter, the baseline's projections of smaller annual deficits and emerging surpluses diminish the government's need for additional borrowing, causing debt held by the public to shrink to 20 percent of GDP by 2017.

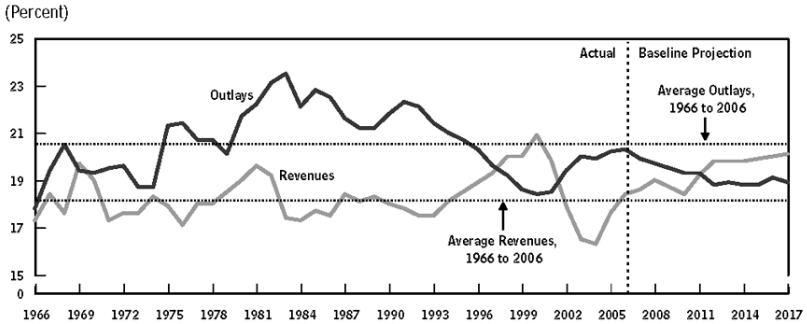
CHANGES IN THE BASELINE BUDGET OUTLOOK SINCE AUGUST

Although the long-term budgetary picture continues to be worrisome, the baseline outlook for the next 10 years has brightened in the five months since CBO issued its previous projections.[4]

[4] Those projections were published in Congressional Budget Office, The Budget and Economic Outlook: An Update (August 2006).

Figure 2.

Total Revenues and Outlays as a Percentage of Gross Domestic Product, 1966 to 2017



Source: Congressional Budget Office.

Budgetary outcomes have improved for each year from 2007 to 2016 (the period covered by the previous projections), from a reduction of $114 billion in the deficit for 2007 to a swing of $285 billion in the bottom line for 2016 (from a deficit of $93 billion to a surplus of $192 billion). In all, those reductions represent a difference of about 1.2 percent of GDP over 10 years.

Those changes overstate the fundamental improvement in the underlying budget outlook, however. Roughly half of the total change stems from the baseline's treatment of previous supplemental appropriations for disaster relief and the irregular pattern of funding for military operations in Iraq and Afghanistan. Consequently, more than half of the improved bottom line is unrelated to changes in the underlying budgetary and economic environment.

Much of the remaining change to the current baseline comes from lower projected spending for Medicare. Total outlays for that program over the 2007-2016 period are nearly 8 percent lower in this baseline than in CBO's August projections. That reduction is largely attributable to new estimates of per capita costs for all Medicare benefits, but it also reflects lower projections of the number of enrollees in the prescription drug benefit program. Those recent changes, however, do not significantly alter the upward trajectory of Medicare spending in the long term.

THE ECONOMIC OUTLOOK

The Federal Reserve's shift in monetary policy over the past two and a half years and the recent decline in housing construction are expected to restrain economic growth this year, but the economy is likely to post solid gains next year. CBO forecasts that GDP will grow by 2.3 percent in real terms in calendar year 2007 but by 3.0 percent in 2008 (see Table 2).

Gains in employment, which remained solid in 2006 despite a slowdown in economic growth during the second half of the year, are expected to lessen in 2007. That change may cause unemployment to edge up from the 4.6 percent rate recorded for 2006. As housing construction stabilizes, however, economic growth and employment should start to recover by the middle of 2007.

SUMMARY TABLE 2.—CBO'S ECONOMIC PROJECTIONS FOR CALENDAR YEARS 2007 TO 2017

[Percentage change]

	Estimated 2006	Forecast		Projected Annual Average	
		2007	2008	2009–2012	2013–2017
Nominal GDP:					
Billions of dollars	13,235	13,805	14,472	(1) 17,395	(2) 21,519
Percentage change	6.3	4.3	4.8	4.7	4.3
Real GDP	3.3	2.3	3.0	2.9	2.5
GDP Price Index	2.9	1.9	1.8	1.8	1.8
PCE Price Index [3]	2.8	1.7	1.9	2.0	2.0
Core PCE Price Index [4]	2.3	2.1	1.9	2.0	2.0

SUMMARY TABLE 2.—CBO'S ECONOMIC PROJECTIONS FOR CALENDAR YEARS 2007 TO 2017—Continued

[Percentage change]

	Estimated 2006	Forecast		Projected Annual Average	
		2007	2008	2009–2012	2013–2017
Consumer Price Index [5]	3.4	1.9	2.3	2.2	2.2
Core Consumer Price Index [6]	2.6	2.6	2.3	2.2	2.2
Unemployment Rate (Percent)	4.6	4.7	4.9	5.0	5.0
Interest Rates (Percent):					
Three-month Treasury bills	4.7	4.8	4.5	4.4	4.4
Ten-year Treasury notes	4.8	4.8	5.0	5.2	5.2

Sources: Congressional Budget Office; Department of Commerce, Bureau of Economic Analysis; Department of Labor, Bureau of Labor Statistics; Federal Reserve Board.

Notes: GDP = gross domestic product. Percentage changes are year to year.Year-by-year economic projections for 2007 to 2017 appear in Appendix E.

[1] Level in 2012.
[2] Level in 2017.
[3] The personal consumption expenditure chained price index.
[4] The personal consumption expenditure chained price index excluding prices for food and energy.
[5] The consumer price index for all urban consumers.
[6] The consumer price index for all urban consumers excluding prices for food and energy.

Last year, robust investment by businesses and solid growth in exports helped the U.S. economy absorb the decline in housing construction. Investment and exports are expected to continue to support the economy in 2007. For many years, businesses' capital stock (the plant, equipment, and software they use for production) grew more slowly than overall demand for U.S. goods and services; as a result, despite the recent growth of investment, the nation's capital stock is still low relative to the level of demand. Investment should therefore continue to increase, even if the growth of demand slows. Similarly, export growth is likely to remain strong because increases in demand for U.S. products overseas are durable enough to withstand a slight slowdown in U.S. demand for other countries' exports.

In the absence of any adverse price shocks to the economy, the core rate of inflation—which excludes prices for food and energy—is expected to ease slightly this year. Overall inflation (as measured by the year-to-year change in the price index for personal consumption expenditures) will fall from last year's rate of 2.8 percent to 1.7 percent in 2007 because of a large drop in prices for motor fuels near the end of last year. The core rate of inflation, however, is expected to decline less rapidly during 2007.

CBO anticipates that the interest rate on three-month Treasury bills will drop slightly this year from the 4.9 percent rate seen at the end of 2006. Further declines are expected during 2008, when that rate will average 4.5 percent. CBO's forecast assumes that long-term interest rates will edge up as short-term interest rates decline. The rate on 10-year Treasury notes, for example, is forecast to rise from 4.8 percent this year to 5.0 percent in 2008.

Beyond the two-year horizon, CBO projects that economic growth (as measured by increases in real GDP) will average 2.7 percent a year from 2009 to 2017. As members of the baby-boom generation begin to retire, the growth of the labor force is expected to slow, pushing down the rate of real GDP growth during the second half of that period. Projected rates of inflation, unemployment, and growth of labor productivity average 2.0 percent, 5.0 percent, and 2.2 percent, respectively, after 2008. Interest rates are projected to average 4.4 percent for three-month Treasury bills and 5.2 percent for 10-year Treasury notes.

Chairman SPRATT. Of course, like I was referring earlier to some of the positive changes in your forecast, if you read all the way to appendix B, you find CBO has made some major changes, which you have testified, in the so-called baseline since just last August, in a matter of months. The cumulative changes come to how much?

Mr. ORSZAG. The cumulative changes come to 2 point—over $2 trillion.

Chairman SPRATT. Over $2 trillion between 2008 and 2017.

Mr. ORSZAG. No. It is $2.1 trillion, Chairman Spratt, between 2007 and 2016. We do it over that window because that was the window used in August.

Chairman SPRATT. And the remaining bottom line is a surplus?

Mr. ORSZAG. That is correct. Roughly $400 billion now.

Chairman SPRATT. If you keep reading, you find that more than half of these changes related to the way you adjust for supplementals.

Mr. ORSZAG. Correct.

Chairman SPRATT. Would you expound upon that? We have got the war costs, we have got the Katrina costs, we have got various costs. Under current law you are obligated to carry forward prior-year supplemental appropriations. But in the case of defense, only $70 billion has been appropriated, so that is your carry forward; is that correct?

Mr. ORSZAG. That is correct.

Chairman SPRATT. The difference between that and what was appropriated in 2006——

Mr. ORSZAG. Is about $50 billion.

Chairman SPRATT. And the carry forward on that accounts to how much over a 10-year period of time?

Mr. ORSZAG. About $500 billion.

Chairman SPRATT. So just in adjusting for the baseline, which is a technical adjustment really, you have got a substantial adjustment to the bottom line.

Mr. ORSZAG. And again, Mr. Chairman, that is only with regard to defense discretionary spending. There is also another roughly $500 billion of basically the same thing on the nondefense side. So a trillion dollars total.

Chairman SPRATT. Well, in particular, Medicare, while you just gave us the dire possibilities given the rate of growth in the Medicare program, what you have found in looking forward 10 years, 2007 to 2016, is a substantial reduction, I think it is $588 billion cumulative cost reduction in Medicare since your last forecast?

Mr. ORSZAG. I believe it is $445 billion.

Chairman SPRATT. Four hundred forty-five.

Mr. ORSZAG. But in any case, it is a significant adjustment.

Chairman SPRATT. Medicaid is $70 billion?

Mr. ORSZAG. A little bit above $70 billion reduction, yes.

Chairman SPRATT. Any other adjustments like that of that magnitude?

Mr. ORSZAG. Those are the most substantial ones, but I want to return for a second to nondefense discretionary spending, because in addition to the Medicare and Medicaid reductions that you noted, there is also less nondefense discretionary spending because we have not had a repeat of the hurricane spending in 2007. So that also accounts for roughly $500 billion lower discretionary spending in this baseline.

Chairman SPRATT. All right. Let me put up our first chart, which you have seen many times and everyone else has, but it goes directly to the point you are just making. There are two diverging curves here. The lower curve—the upper curve plots your baseline. I am not sure whether it includes the adjustments you have made in this report or not, but I believe it does. The lower curve——

Mr. ORSZAG. I think it does.

Chairman SPRATT. Yeah.

Mr. ORSZAG. It goes above zero.

Chairman SPRATT. But beginning in 2006, 2007, there is a steadily widening divergence between where we would go if we assume politically what will happen with the Bush budget and where CBO will take us with your particular baseline. When you get to the end of the period of time, I can barely see, but I think that deficit is $500 and some odd billion. Your corresponding deficit on page 2 is $476 billion for that point in time, that particular period. It is my understanding that we are using slightly different assumptions about war costs.

Now, would you walk us through the changes that account for that divergence? First of all, a reestimation of war costs; secondly, the extension of the 2001 and 2003 tax cuts; and thirdly, leaving the AMT unadjusted or adjusted, or leaving the AMT as is.

Mr. ORSZAG. Okay. And again, the $502 billion figure you are showing there is your calculations. What I can do is walk you through some of the changes in policy that we show in table 1-5 that would have a material effect on the 2017 outcome.

So as we show in table 1-5, if one extended the 2001 and 2003 tax provisions rather than allowing them to expire in 2010, the revenue reduction in 2017 would be $333—sorry—$330 billion and there would be additional debt service of $94 billion. So that gets you to a total of roughly $424 billion from that provision.

Chairman SPRATT. That is a cumulative revenue effect of renewing the expiring tax cuts?

Mr. ORSZAG. No. I am sorry. That is in 2017 alone. Over the 10-year window as a whole, that policy change by itself would have a budgetary effect inclusive of debt service of $2.2 trillion.

Chairman SPRATT. $2.2 trillion.

Mr. ORSZAG. Correct.

Chairman SPRATT. Due to the renewal of these expiring tax cut programs alone.

Mr. ORSZAG. That is correct.

If you then also extend other expiring tax provisions like the research and experimentation tax credit and other things that are scheduled to expire over the 10-year window, that is an additional almost $500 billion, and then the alternative minimum tax combined with making the 2001 and 2003 tax legislation permanent or extending it past its currently scheduled sunset would raise—I mean, would incur an additional budgetary effect of over a trillion dollars also.

Chairman SPRATT. Say it again, please, sir.

Mr. ORSZAG. The alternative minimum tax effect in the face of extending the 2001 and 2003 tax legislation, because there is an interactive effect, would involve a budgetary cost of over a trillion dollars over the next 10 years.

Chairman SPRATT. That alone, on top of the $2.2 trillion.

Mr. ORSZAG. Correct.

Chairman SPRATT. In other words, if we fix the AMT so that it does not reach any more taxpayers than it reached last year, the cost in revenues over a 10-year period of time, 2007 through 2016, would be a trillion dollars.

Mr. ORSZAG. Slightly more than that, yes.

Chairman SPRATT. And that would add to the $2.2 trillion due to the extension of the expiring tax cuts due to expire in 2010.

Mr. ORSZAG. That is correct.

Chairman SPRATT. War costs. How do you treat war costs? Let me just stop to you say—I am not trying to answer your question or lead the witness. You are a hell of a lot smarter than I am.

Mr. ORSZAG. I am very cautious whenever you say something like that, but go ahead.

Chairman SPRATT. You give two different estimates, ways of looking at the ongoing cost of the war.

Mr. ORSZAG. That is correct.

Chairman SPRATT. Would you take a minute just to describe how you did that and why you did that?

Mr. ORSZAG. Sure. We provided two different paths for potential defense spending associated with Iraq, Afghanistan, and the global war on terrorism in particular, in part because I think there is widespread acknowledgement that there will be some divergence between merely taking the $70 billion that has been enacted thus far and kind of inflating that out into the future. So we provide you with two alternative paths.

One would involve—they both involve some increase in troop levels in the near term, and then they phase out at different rates into different levels. So in particular under one alternative, you wind up with 30,000 troops involved in those activities by 2010, so a more aggressive phasing out; and then the other alternative you wind up with 75,000 troops by 2013. Under both alternatives there is more spending than under the baseline in the short term, and there is less spending by 2017 than in the baseline.

Chairman SPRATT. That is, the baseline otherwise carries forward the $70 billion thus far appropriated in 2007?

Mr. ORSZAG. Correct. Under the first alternative that I mentioned in which you wind up with 30,000 troops there is a net—over the 10-year window, you have those higher costs at the beginning and lower costs at the end, a net budgetary savings of a little bit over $300 billion. Under the second alternative where you have a slower phase-down, and you wind up with a higher troop level relative to the first alternative, there is a net budgetary cost, including debt service, of a little bit over $200 billion, and that is because your savings don't quite offset the nearer-term costs.

Chairman SPRATT. On page 2 when you say that the—if you make these assumptions that the deficit would be $476 billion instead of a surplus of $249 billion in 2017, what assumption are you making about the ongoing war costs?

Mr. ORSZAG. That just takes the baseline assumptions with regard to discretionary spending.

Chairman SPRATT. Seventy billion dollars and carries it forward.

Mr. ORSZAG. Correct.

Chairman SPRATT. So it tends to understate the near term and probably, we hope, overstate the outyears. But in any event, once you make these adjustments, the path we are looking at is radically changed; is it not?

Mr. ORSZAG. For example, under the change in policy that I showed you with discretionary spending excluding the war on terrorism, keeping pace with overall economic growth and with the tax provisions extended and the alternative minimum tax stabilized instead of having a falling deficit and moving it to surplus, you have a rising deficit as a share of the economy from a little under 1½ percent of the economy this year to more than 3 percent of the economy by the end of the budget window.

Chairman SPRATT. So the choices we make this year and next year are going to have a profound effect on the outyears and determine whether or not we continue on the deficit-ridden path we have been taking, or whether or not we begin to put this budget back into balance in 2012.

Mr. ORSZAG. There clearly is, even over the 10-year window, an impact from changes in policy or from policy choices on budgetary outcomes. And I would again note, though, what we do over the next 10 years has importance, but the central long-term challenge facing the Federal Government in terms of budgetary outcomes has to do with that longer-term problem involving health care costs. So we need to be able to keep both problems in mind.

Chairman SPRATT. One final question. One of the big issues, and maybe one of the big differences between CBO and OMB, will be revenue growth. Would you take just a minute to explain what you have assumed, CBO has assumed, with respect to revenue growth since substantial revenue growth over the last couple of years has had a remarkable, dramatic effect upon the bottom line? I think we have had 11.7 percent growth between 2006 and—between 2005 and 2006, and the question is, can we expect the growth rate to continue at those high levels, or do you see it reverting to normal?

Mr. ORSZAG. Well, under the baseline we have an irregular pattern of revenue growth because we incorporate current law with regard to revenue. So the expiration of various tax provisions can cause very significant growth rates around those sunset years, but if you abstracted from that and so, for example, looked at a path that did not allow the sunset to occur, what would happen is that we would have somewhat slower revenue growth towards the end of the projection period than towards the beginning for a couple of reasons. One is that overall economic growth is projected to slow, and I think this is a very important point. As the workforce enters retirement age, the growth rate of the workforce will slow relative to historical rates, and that will slow overall economic growth, and that slower overall economic growth will have a dampening effect on revenue growth also.

In addition to that phenomenon, the part of the revenue uptick that we cannot explain based on known factors is assumed after 2008 to revert to more normal historical patterns because that is the traditional way that—or that is what has tended to happen in the past, that these sort of forecast errors or unexplained components tend to revert to more normal patterns relative to the economy as a whole. So that is what we assume after 2008.

Those two factors may well mean that our revenue growth in the outyears and, you know, in 2016 and 2017 is slower than the administration's projections, but we will need to wait and see what the projections are when they release their budget next month.

Chairman SPRATT. Thank you very much, Mr. Orszag.

Mr. ORSZAG. Mr. Spratt, if I could quickly make one—the $588 billion figure you mentioned is the change for all mandatory spending, which includes the $445 billion for Medicare and then additional spending on Medicaid and some others.

Chairman SPRATT. But the point I was trying to make was even with these substantial favorable developments, when you go back and factor in the tax cuts extension in 2010, and you factor in the cost or the likely cost of the war, and you leave the—you assume that the AMT will be sort of neutralized in place, you have got a profound change in the course of the budget, and we are back deep in deficits again, notwithstanding these very favorable changes you have made otherwise to your forecast; is that a correct simulation?

Mr. ORSZAG. Again, changes in policy relative to current law with regard to both revenue and spending could have a significant effect on budgetary outcomes over the next 10 years.

Chairman SPRATT. Thank you, sir.

Mr. Ryan.

Mr. RYAN. First, let us go back to the Medicare savings you talked about. Your new baseline says that Medicare spending is projected to be $445 billion less than the August baseline; is that correct?

Mr. ORSZAG. That is correct.

Mr. RYAN. Break that down again; $265 billion for Part D.

Mr. ORSZAG. For Part D. The rest appears to be concentrated mostly in Part A, but we are still looking at exactly what is going on between Part A and Part D.

Mr. RYAN. And the $265 billion savings off the August baseline comes from what exactly?

Mr. ORSZAG. The majority comes from the lower cost per beneficiary; in other words, the PDPs, the prescription drug plans, and the Medicare advantage plans are coming in lower than we projected.

Mr. RYAN. So that is lower cost because lower prescription drug prices are being reimbursed?

Mr. ORSZAG. Correct.

Mr. RYAN. And so you are seeing downward bend in the growth curve in Medicare in the new program, Part D and Medicare advantage, than previously. And enrollment, you said your enrollment numbers are getting lower because people are getting coverage elsewhere; is that right?

Mr. ORSZAG. Before I get to that, it is not really that the cost growth in—out in 2016 or 2017 has changed, but rather that there is just a lower level.

Mr. RYAN. Right. You are knocking the base down and then move forward.

Mr. ORSZAG. Correct. In addition to that factor, while enrollment in the very near term has actually been higher than we projected, slightly higher, we now have more information about other coverage that Part D beneficiary—or Medicare beneficiaries have, so instead of assuming that 87 percent of beneficiaries would take up Part D, we are now in the outyears assuming that 78 percent would, and that leads to lower costs.

Mr. RYAN. Eighty-seven to seventy-eight, you said?

Mr. ORSZAG. Correct.

Mr. RYAN. Well, you mention budget policy alternatives to get to balance, which basically we talk about war costs, discretionary spending and tax policy. There aren't really any alternatives offered in the entitlement side of the budget in this new outlook.

It seems that something good has happened in Medicare. It seems that something favorable has happened in Part D where you have—just in one part of this large entitlement program you have got a savings of $265 billion, which without coincidence is the new part that involves more competition within the program which is bringing more savings not only to the beneficiary, but to the taxpayers. Is that not an area that we can discover more as far as future health care spending direction to go toward a competitive model like the Part D program? Does that not lay sort of a groundwork that perhaps where we are seeing substantial savings in the new competitive model within this entitlement program, that that might be a place for more savings to be got in other parts of these entitlements?

Mr. ORSZAG. Well, again, I don't want to jump to conclusions because of the cause of the reduction, but I would fully agree with you that it is encouraging, and, in fact, you know, to the extent that it is continued, could have a material effect on Medicare projections in particular.

Mr. RYAN. It just seems to me that this is something we need to look at quite a bit more because this is—of all the good news in this, it is all overshadowed by the entitlement explosion. But within the entitlements we are seeing less spending because of this new program, which is providing a competitive product where providers compete against each other for beneficiaries' business, and that active competition has actually lowered the cost of the program.

Let me go over the revenue estimates. Obviously if you take a look at the baseline—I won't ask for the chart back up. If you just let the tax cuts go away to go to balance, and that is all the tax cuts you are talking about, all the 2001 and 2003 and the expiring provisions, those are what you assume go away because that is what current law is, and that is what brings us into surplus in 2012, correct?

Mr. ORSZAG. Correct.

Mr. RYAN. So that means if we get rid of the per child tax credit, if we get rid of the marriage penalty, if we raise income tax rates across the board on every taxpayer, if we bring the death tax pack to pre-2000 levels, and if we get rid of the lower rates on capital gains and dividends, those are all of the tax cuts you are talking about go away, then we will go back in the balance and therefore surplus, right?

Mr. ORSZAG. That is the alternative, the change in policy that is shown in table 1-5.

Mr. RYAN. It is the revenue estimates themselves that give me a little bit of a cause for concern. If you take a look at CBO's forecasting record on overall revenue, let us just take a look at one of these components, capital gains taxes, which I would argue probably has the best macroeconomic feedback effect of any of these tax changes. I am not saying all tax cuts pay for themselves, but if you take a look at the initial CBO forecast, say, for the lower rate on capital gains taxes, CBO projected revenue to be $42 billion in 2003, $46- in 2004, $52 billion in 2005 and $57 billion in 2006. And what actually had occurred was 51- in 2003, 72- in 2004, 97- in 2005, and $110 billion in 2006. Overall CBO's forecast on capital gain revenues were off by 68 percent, so when you take a look at the fact that, you know, CBO and using joint tax numbers were so far off on estimating the revenue loss associated with just this particular tax change, it makes one think about whether or not your estimates for all the new revenues that would come in with these tax increases are quite there or not, because it seems like these don't accurately take into consideration a realistic assumption on the macroeconomic feedback effect on some of these.

Not all tax cuts are the same, it is clear, but my fear is that if we just take this money to the bank and say, let us just raise all these tax rates across the board, this money will show up, well, that is not what happened when we cut the tax rates. We didn't lose as much as we thought we would, so I wonder if we are going to gain as much as we think we are going to gain if we let all these tax cuts go away.

The point I am trying to make is, even if we do this, even if we let all these tax cuts expire, and we achieved that line on the chart, put all the other factors aside, is it not true that just as we did after 2017, we pretty much go back into deficit soon thereafter because the entitlement growth just swamps this?

Mr. ORSZAG. Yes. We would eventually go back into deficit.

Mr. RYAN. So even if we let the tax cuts expire, we are going back into deficits.

Mr. ORSZAG. The ongoing increases in health care costs in particular will eventually overwhelm the budget.

Mr. RYAN. Okay. I just have a quick baseline question on the war. Is the way you assumed war costs going out is you just take the last supplemental and you run that through the baseline? So the last supplemental was $70 billion, and so is that basically the plug you put in for for the next 5 years? Is that essentially how you are doing this in your baseline?

Mr. ORSZAG. Essentially, although I would note that the outlays associated with previous budget authority that had been provided spends out over the budget window. But, yes, you are basically correct.

Mr. RYAN. So if we get a $100 billion supplemental in a month or two, and you are redoing the baseline next time around, you will take the 70- out and put the 100- in and carry that out, is that basically how the baseline would be affected?

Mr. ORSZAG. It would be added because they would both be for the same fiscal year.

Mr. RYAN. That is right. That is right. Because it would be the same. So it would be 170- you are carrying out.

One more quick question. The workforce participation rates. These assumptions are really interesting to me. You are using these workforce participation rates, because of the aging of our society and because of boomers coming into retirement, the demographics are such that workforce participation rates would decline; therefore, that would negatively affect the economy.

Are you using the same assumptions on retirement rates that the models have been using for years? Meaning, are you taking into consideration that people are actually working longer these days; that people are working well into their seventies, whereas 20 years ago, you pretty much retired at 65, where today you retire more at 75?

My question is does that model take into consideration longer work periods for and longer workforce participation by this new generation of people? You know, the generation before, the boomers pretty much retired at 65. These boomers seem to be working a lot longer. I am just curious whether you have taken that into consideration in your model or not.

Mr. ORSZAG. Yes. And obviously one could debate how much, but basically what has happened over the past 10—well, going back over a longer period of time is workforce participation rates for, say, those in their early sixties were declining substantially. They then kind of stabilized and have increased a bit over the last 10 years, rising from sort of the midforties to kind of the midfifties. For those in their late sixties, workforce labor participation rates are a lot lower than they are, in sort of the 20 percent range or so.

We assume some additional increase in the projection window, but I think the important point is to offset the effect of moving more of the population into those age groups would require—and to have it have no effect on the overall participation rate, you would have to get those rates up to the rates for like people in their late fifties. Those are up near like 70 percent, and that is basically implausible.

Mr. RYAN. Right. Okay. Thank you.

Chairman SPRATT. Mr. Edwards.

Mr. EDWARDS. Dr. Orszag, could you tell me, based on whatever assumptions you have made, what percent of the 2006 and 2007 deficits are due to tax cuts passed since 2001?

Mr. ORSZAG. That is a difficult calculation. One could take the original revenue projections, I suppose, and compare that to the existing deficit, but that is not a calculation that we have done.

Mr. EDWARDS. Okay. Could you make whatever assumptions you would need to make and present that back to the committee?

Mr. ORSZAG. I guess we are being asked to do so, so we will.

Mr. EDWARDS. Good.

[The information follows:]

CBO RESPONSE TO MR. EDWARDS

According to the original scoring of various enacted laws by the Joint Committee on Taxation, legislation since 2001 reduced revenues by $190 billion for 2006 and by $221 billion for 2007.

Mr. EDWARDS. Secondly, do you have with you now, or could you put together, for the past 10 years both short-term and long-term projections made by OMB and CBO, and then juxtapose with that what the actual deficits were compared to the projected deficits, to show the difference between the CBO projections and the actual reality?

Mr. ORSZAG. Yep.

Mr. EDWARDS. Partly—not to criticize CBO, but certainly clarifies that CBO has to live under certain assumptions that simply are not realistic. Is it fair to say the actual deficits have been on the whole larger than the short-term and long-term projections by CBO over the past 5 years?

Mr. ORSZAG. Over the past 5 years as a whole, if you started with, say, the January 2001 projections, the budget outcomes have certainly been worse in the sense of much larger deficits rather than the surpluses that were projected at that time.

Mr. EDWARDS. Okay. Am I correct also that CBO did a study a year or two ago requested by the Republican Majority on the dynamic impact of tax cuts and actually came to the conclusion that one very probable outcome of tax cuts paid for by borrowing money from foreign governments, including the Chinese and others, those tax cuts paid for by borrowing money from foreigners and other groups actually could slow down economic growth; is that correct?

Mr. ORSZAG. It is possible. The effects of tax reduction on the economy will reflect where you are starting, you know, the existing tax rates, the type of tax change you make, and then how you finance it, and financing it for some period of time through additional deficits imposes sort of a countervailing force. So a reduction in marginal tax rates, for example, might encourage more work and more investment and more risk taking, and that could boost the economy, but financing it through a deficit reduces national saving. That puts a drain on the economy, and the net effect of those two forces could be slightly positive or slightly negative, although it is typically quite small.

Mr. EDWARDS. Do you believe that generally a dollar in tax cuts create a dollar in additional revenue to make up for the dollar lost in revenue and tax cut?

Mr. ORSZAG. There is no credible evidence suggesting that that is the case.

Mr. EDWARDS. Thank you.

Chairman SPRATT. Mr. Porter of Nevada. The reason I am doing this is that he was here at the time the gavel went down and before that; he was the first to appear. This is a reward for early behavior. In the future we will record the people who are sitting in their seats at the time the gavel goes down.

Mr. Porter?

Mr. PORTER. Thank you, Mr. Chairman. I appreciate that vote of confidence. I will be on time in the future, too. Thank you very much.

Doctor, again we appreciate your being here, and I guess you may have addressed in your backup material, but I haven't been able to find it. Regarding deficits and 9/11, is there a way to equate the impact on our national deficit based on the attacks on New York and Washington in 2001?

Mr. ORSZAG. Well, I can answer that in a couple of different ways. There was, as you know, an economic slowdown that occurred around that time. That economic slowdown did have an adverse effect on budgetary outcomes, and that is one effect, although I would note that most studies that try to directly link the attacks themselves to that economic slowdown suggest that there is not all that much of a connection, in part because of the timing of the two events.

Secondarily, there is also new spending that is associated with new efforts to better protect the United States, including both the global war on terrorism and homeland security efforts. And we do provide figures for both homeland security spending and for the global war on terrorism spending in this document, and, you know, combined for 2007, just looking at enacted appropriations, that would be more than $100 billion.

Mr. PORTER. And certainly it is not a perfect science, but if we could go back to 2001 into our U.S. economy, I heard estimates of a trillion dollars or less, the impact on our national economy. Do you know of any numbers, separate from our deficits as a government, but to the U.S. economy—is there estimates that were placed based on the loss to our economy?

Mr. ORSZAG. There were some. One of the things about both natural catastrophes and other catastrophes like terrorist attacks is that the human cost is very, very substantial. Most of the analysis that has been done of the overall macroeconomic impact has suggested a more modest effect from both natural disasters and human-induced disasters like a terrorist attack. So there were some attempts to provide an aggregate impact number.

I don't believe that CBO has examined that question, and most attempts—most things—most analyses that have tried to do so have suggested relatively modest effects in the context of an economy that is now $13 trillion a year.

Mr. PORTER. I can give a Nevada experience as a tourist destination for the world. And we are a bellwether on the positive side of the economy. When things are good, we are very busy in Nevada because people are comfortable, and they can travel. But we were literally out of business for a number of months in Nevada. People were afraid to get on a plane. They were afraid to leave their homes in many respects.

So there was a serious hit on our economy, and I would like to get for the record some of our statistics. I don't have them with me today, but there is no question that 9/11 changed our country and put a major impact on our budgets as businesses and as families, but also as a Federal Government. I just want to make sure as we are talking about some of the reasons that we are where we are today certainly had a lot to do with what happened in 2001.

Mr. ORSZAG. And again I would say that, you know, there was—you can see it in the numbers—a material effect on the budget, and I would also note on particular areas within the United States, your State, obviously activities in New York City itself and elsewhere, and just to be clear, my comments were only with regard to the overall macroeconomic effect which might be more modest than the effect in particular areas.

Mr. PORTER. Thank you.

Thank you, Mr. Chairman.

Chairman SPRATT. Mr. Doggett.

Mr. DOGGETT. Thank you, Mr. Chairman.

Dr. Orszag, I would like to just continue some of the questions Mr. Edwards was asking you and talk about this cure-all that is offered to the American people and all kinds of economic weather and big gulps of tax elixir, tax cut elixir.

We heard testimony recently from the Comptroller General David Walker. We have heard comments from even one of the former chairmen of President Bush's Council of Economic Advisers that the Bush tax cuts have not paid for themselves, and they will not pay for themselves. Do you agree with that?

Mr. ORSZAG. All of the studies that I have seen from credible analysts, including the Department of Treasury, suggest that the tax cuts may have helped to spur the economy somewhat in the short term, and that that offsets some of their costs, but the offset especially over the long term comes nowhere near the cost itself. In other words, the tax cuts do not pay for themselves, and only a very small share of their revenue cost is offset from the economic growth effect of the cuts themselves.

Mr. DOGGETT. Well, I appreciate your qualifying your answer by saying credible evidence, and I believe that was the term that you used with Mr. Edwards, because we have heard plenty of incredible comments within the halls of Congress and, of course, by some of those who observe Congress and feel that the tax cut elixir will solve all of our problems.

Indeed, to be more specific as it relates to the deficit for the year 2007, I believe the Joint Committee on Taxation has already estimated that the total cost of the Bush administration tax cuts in 2007 will be higher than the budget deficit for this year. Is that an estimate that seems reasonable to you?

Mr. ORSZAG. It is possible. The original estimates of the revenue effects associated with the 2001 and 2003 tax provisions, including the alternative minimum tax, were about 2 percent of the economy, and our projected deficit is a little under 1½ percent of the economy.

Mr. DOGGETT. It is either the tax cuts then amount to either the total amount of the deficit or almost the total amount of the deficit, the numbers.

Mr. ORSZAG. Again, those were based on the original projections from the Joint Committee on Taxation, and just comparing them to this year's deficit without taking into account a potential effect on economic activity and others, but if you just did that simple comparison, that would be the conclusion you would reach.

Mr. DOGGETT. And again, I believe you will provide some additional specific analysis to Mr. Edwards on that.

Mr. ORSZAG. I gather so, too.

Mr. DOGGETT. You have pointed out that whether it is your analysis or that of OMB, that just the slightest variations in the assumptions can produce very different answers. I suppose, for example, you can assume away this year's deficit if you have enough phony assumptions to put in place. And I want to ask about some of the assumptions that were made by the Bush administration back in 2002 when they forecast what this year would look like as a result of all of our great policies, and I believe that the original estimate was that we were going to be in much better shape this year than we turned out to be. Do you have information on those contrasting estimates?

Mr. ORSZAG. Sure. I should have the original 2000—well, what I have is the official baseline from 2001, and what that suggested was that in January of 2001, the projected baseline outcome at that point for fiscal year 2007 was a surplus of $573 billion.

Mr. DOGGETT. So their view was of a $573 billion surplus for this year?

Mr. ORSZAG. Again, that was the official baseline, CBO's numbers for the official baseline in January 2001, $573 billion for this year.

Mr. DOGGETT. So even if you subtract out the cost of the war on terrorism, that is a pretty wide variation, isn't it, from what we really ended up with?

Mr. ORSZAG. That is obviously a significant difference from——

Mr. DOGGETT. And I think as we look at framing this budget, it will be important to not only consider the Federal deficit, but the deficits the policies of the Bush administration have created in education, in health care and in other areas for so many American families, and to look at what caused this deficit and not to fault those who didn't cause the deficit for this problem. Thank you, Mr. Chairman.

Mr. ORSZAG. Mr. Chairman, if I could actually for just a second——

Chairman SPRATT. Certainly.

Mr. ORSZAG. I realize I am looking at the table. I might be able to answer Edwards's question directly.

The revenue legislation that was enacted since 2001 based on the original scoring of that legislation amounts to over $200 billion for 2007, $273 billion including economic and technical changes, $221 billion just for the legislative changes itself. So that may be the number that you were looking for.

Chairman SPRATT. Mr. Hensarling.

Mr. HENSARLING. Thank you, Mr. Chairman. Did I arrive early as well?

Dr. Orszag, with this continuing discussion of tax relief, I believe last week we heard from Comptroller Walker that although not all tax relief may pay for itself, that some tax relief, especially dramatic reductions in marginal rates, do. I don't have that testimony in front of me, but I feel that is accurate. Do you agree with Comptroller Walker?

Mr. ORSZAG. Again, I did not see his particular statement, but the analyses that the Congressional Budget Office, the Department of Treasury and other entities have done suggest that reductions in marginal tax rates in general—and it depends on where you start from if you are starting from 70 percent or 80 percent rates is different than if you are starting from 35 or 40 percent rates—do not pay for themselves in the sense of having an economic growth effect that offsets their full cost. The precise results will depend on how you finance the tax change, though.

Mr. HENSARLING. I believe I have it now that the Comptroller General said marginal rates do pay for themselves, and that indeed our capital gains tax cuts have paid for themselves several times over. Isn't it indeed true that since we have had the tax relief of 2001 and 2003 that we have dramatically larger tax revenues?

Mr. ORSZAG. Revenues in nominal terms are now higher than they were in 2001.

Mr. HENSARLING. Isn't it also true that we have the largest amount of tax revenue in nominal terms than we have ever had in our tax history?

Mr. ORSZAG. Yep.

Mr. HENSARLING. I think that one area of agreement that you have with the Comptroller, and I don't want to put words in your mouth, but I think you said something earlier in your testimony that the central fiscal challenge we face as a Nation was our rising health care cost curve. Is that a fair assessment of what you said?

Mr. ORSZAG. Yes.

Mr. HENSARLING. Did I also understand you to say that it is possible to bend that growth curve without necessarily degrading our health care quality and accessibility? Did you say something along those lines?

Mr. ORSZAG. I think that there is an opportunity to do so, and the central challenge is figuring out exactly how that can be done. We are not yet in a position to make the changes that would produce that outcome, but I think it is—there is hope that it is possible.

Mr. HENSARLING. So logic would tend to dictate, then, that every reduction in a growth curve does not necessarily lead to a lesser commitment or a lesser quality of health care. For example, it wasn't all that many years ago—we trip across these things from time to time—I recall Medicare was paying as much as five times as much for a wheelchair than what the market forces would have cost, and they did that because they didn't have competitive bidding. I think we went back and corrected that one. But would that be an example of somebody is getting the same wheelchair, the same model from the same manufacturer at a cost that is less to the taxpayer? So it is one small little anecdote, but wouldn't it seem to suggest that it is possible to find reforms that might save money and not degrade health care?

Mr. ORSZAG. It certainly does, and perhaps even on a broader scale there is evidence that Medicare costs per beneficiary vary a lot across different regions of the country in ways that don't correspond to health outcomes, raising the possibility that there could be very significant cost growth taken out of the system again without impairing innovation or harming health.

Mr. HENSARLING. Dr. Orszag, returning to the deficit question, let us assume for the moment that all your assumptions are right. Let us assume we allow the tax relief to expire.

If we don't reform and bend this health care cost curve, what does the tax burden look like on the next generation, say 30 years from now, people's children and grandchildren in this room.

Mr. ORSZAG. Do you mean if we allowed——

Mr. HENSARLING. If we wanted to balance our budget 30 years ago from today, we would go ahead and get rid of all of this tax relief. We would let it expire. If we wanted to balance the budget 30 years from now, if you have got a figure, 40, 20, what is the tax burden it is going to take? What is the magnitude of tax increase to be placed on the American people if we do not reform this entitlement spending?

Mr. ORSZAG. If cost grows, continues to grow about the same rate as in the health sector as it did over the 40 years and you finance that entire revenue side on the budget by the mid-2030s, it would be an increase of about 10 percent of the economy relative to a current base of about 18½ percent now. So a very, you know, more than a 50 percent increase in revenue as a share of the economy.

Mr. HENSARLING. 50 percent increase.

Mr. ORSZAG. From roughly 18½ to closely 30.

Chairman SPRATT. Thank you.

Mr. Etheridge from North Carolina.

Mr. ETHERIDGE. Thank you, Mr. Chairman.

I would like to thank you and thank you for being here. A couple of questions if I can go back. I may have written the numbers down incorrectly. You are talking about the assumptions on the part D for the number that dropped, and I believe you said that the assumption originally used was about 87 percent assumption rate down to 78.

Mr. ORSZAG. Correct.

Mr. ETHERIDGE. Let me ask you a question on that. Because assuming that you—and you use that to extrapolate your number out. The question I have is that part of that has to do with people looking at the plan that was provided under part D and recognizing they had a better plan that was being offered. That much I do know. I mean, you don't have to answer that. I know that is a fact. The question I have is this, though. Because a lot of State plans that offered prescription medicine for retirees and they decided to stay with the plan rather than to move because they have a better plan. The question I have is as you look out, extend the years out for employers, does it encourage employers to decide we aren't going to continue to offer this, we are going to slowly move out of it? What does that do for the cost in outyears if that should happen?

Mr. ORSZAG. There are provisions in the Medicare legislation to incorporate employer-based coverage for retirees. But if there were a significant movement away from that system and into——

Mr. ETHERIDGE. From offering a plan.

Mr. ORSZAG. And into Medicare part D, the net effect would depend on the additional cost for the enrollees versus what is effectively paid to the employer for that coverage. I don't have an exact figure for you.

Mr. ETHERIDGE. The reason I raise that number is because more and more people now are falling into what is called the donut hole. And each year it will get quicker for them to get into it, which is— it is going to create a bigger and bigger problem to fix it or people just not, you know, looking for alternatives.

And Social Security, since my time is running out, leaves me with one other area. In your economic model as you extrapolate out in the outyears, does the model take into effect economic downturns in the turns in the economy?

Mr. ORSZAG. There is a slower economic growth assumption for this year because of softness in the housing sector and some other sectors and then economic growth picks up again in 2008 and thereafter. We don't try to predict when recessions and boons will occur and instead try to look at the underlying trend rate of growth.

Mr. ETHERIDGE. So that assumption is the same that legislation is enacted at the level it is at?

Mr. ORSZAG. It is very difficult to predict when a swing in the economy will occur, in 2010 or 2011.

Mr. ETHERIDGE. Help me understand the model as it relates to spending. Because I assume you fill that in. For the dollars invested in the GDP and the U.S. economy versus the dollars that we spend, let us say, in the war on terror or the Iraqi war, Afghanistan, those dollars are spent outside the United States. How does the model take into account the differing view because the factors have to be different for dollars spent inside and outside and internally to generate the GDP?

Mr. ORSZAG. There is a difference in the short term and long term. In the short term, one has to worry about what kind of impact on demand. Domestic demand comes from different spending patterns. Long-term growth assumptions typically focus on—more on the growth rate of the work force and how much we are saving and the capital stock and basically focus on that side of the economy as driving long-term growth rather than the demand side which has more to do with multipliers.

Mr. ETHERIDGE. But I guess my point is if you are looking at something that is extended or protracted over a number of years, would that have a negative effect or the model just doesn't deal with it?

Mr. ORSZAG. I will get back to you but my understanding of long-term modeling assumptions is that different types of spending do not have a material effect on long-term growth rates, that instead they are driven by those other factors that I was describing.

Mr. ETHERIDGE. One final question as the time runs out. You were talking earlier, the issue was raised as it relates to cuts, but if you make a reduction in a tax revenue at the lower end of the bracket where you give a tax credit, doesn't that have a stronger impact on bumping the economy than if you take one or two points off the top?

Mr. ORSZAG. Again, in a situation in the short term where the key—where the economy is weak and the key thing is getting more demand for goods and services that people can produce, CBO has focused on what observations that moderate income household incomes may be likely to spend any dollar that is delivered to them than higher income household in the short term.

Chairman SPRATT. Mr. Campbell.

Mr. CAMPBELL. Thank you, Mr. Chairman. Dr. Orszag, my line of questioning will be to the revenue side. I understand that in order to project revenues right, you have to project interest rates right, you have to project GNP growth right, personal income growth, personal behavior right and if you could do all of that that Warren Buffett would be calling you for advice.

But if my numbers are correct, your projection is a 5.6 percent revenue growth, 2007 and 2006, but my understanding is thus far the revenue growth has been in excess of 8 percent in this fiscal year.

Mr. ORSZAG. I think it is difficult to look at subpatterns within a year because of seasonal factors, and you get a lot of action—for example, there was a lot of action before when people actually filed their tax returns in April and we have more information about specific income trends at that point.

Mr. CAMPBELL. So you are sticking with this in spite of the current—the numbers thus far this year?

Mr. ORSZAG. Yes.

Mr. CAMPBELL. Then the subsequent year you have a 7 percent increase. Why the increase in growth next year over this year?

Mr. ORSZAG. That is because the relief from the alternative minimum tax expires under current law, and you have a fairly significant 50 or $60 billion increase in AMT revenue mostly. There are a few other smaller factors.

Mr. CAMPBELL. It is a tax change. And then after that, taking aside the tax cuts expiring, 3.2 percent kind of is a steady state, is that—where is that in relation to a 20-year average, 30-year average, whatever?

Mr. ORSZAG. That growth rate is going to be lower than during some historical periods because overall economic growth is likely to be lower than in some historical periods because the work force growth, returning to the discussion I had with Mr. Ryan before, is projected to slow as more people enter their 60s basically.

Mr. CAMPBELL. So how much lower is that? I realize you could pick 20 or 30. If you took a 30-year period, how much lower is that? 3.2?

Mr. ORSZAG. What we give you in chapter 2 of the document is our long-term assumptions relative to historical periods, and I am just quickly looking for it because I know we want to get—on page 41 of the document, and what you can see there is that real potential output grows by 2.6 percent over the next 10 years relative to say 3.2 percent over the past 40 years and that is mostly because the potential labor force growth rate slows from 1.7 to .7 percent over the next 10, and that is the major driver of that change.

Mr. CAMPBELL. Looking at the effective tax cuts and so forth since 2003, the total revenue increase since the 2003 tax I think it was 8 percent the first year, just short of 15 percent the next, just short of 12 the year after that. Is that more or less than what CBO projected for revenue growth?

Mr. ORSZAG. That is more.

Mr. CAMPBELL. Do you think, and I know there has been discussion clearly that you don't believe at this level that a dollar in tax cuts yields a dollar in additional revenue to match it, do you believe that there are some economic behavior factors that were generated by those tax cuts that are not taken into account in CBO's projections, or were not?

Mr. ORSZAG. I think there are economic responses into the tax reductions, including by themselves, without looking at the financing side, potentially changing behavior on both for corporations and for individuals. That would have some revenue effect.

Mr. CAMPBELL. I am not saying that this is not at all pejorative, but in your charge, if you were to do these projections, you are not allowed really to take those things into account; is that correct?

Mr. ORSZAG. They are incorporated now into our baseline, and I also should have noted this earlier. The primary responsibility for scoring revenue legislation rests with the Joint Committee on Taxation. That is the first point. The second point is once changes are enacted, they are incorporated into—their effects are incorporated into our baseline, and then the final point, I know there has been a significant uptick in capital gains revenue, but I think it is very important to realize lots of factors cause that, and you can look at short-term gains which were not affected by the 2003 changes. You can look at corporate capital gains that were not affected by the 2003 changes, both of which have boomed, too, and you can look at capital gains abroad, which I don't think were affected by our tax changes. In the U.K. There has been a surge there, too.

Mr. CAMPBELL. We underprojected the growth with the tax cuts and some other time we will talk about whether we are overprojecting the revenue increase from the tax cuts expiring on the CPI and the CPA. I have done tax returns. When taxes go up the first thing you do, you sit down with your client and say how can we avoid paying taxes, and when they go down the first thing you do is you sit down and say what opportunities are there to recognize revenues or gains now because the taxes are lower.

Chairman SPRATT. Ms. Hooley.

Ms. HOOLEY. Thank you, Mr. Chair. Thank you for being here today.

Growth from revenue from corporate tax revenues has been strong?

Mr. ORSZAG. Um-hmm.

Ms. HOOLEY. And growth from individuals who pay individual tax, that has been strong?

Mr. ORSZAG. Um-hmm.

Ms. HOOLEY. But slower growth has occurred in payroll taxes?

Mr. ORSZAG. Relative.

Ms. HOOLEY. Relative to those two?

Mr. ORSZAG. That is correct.

Ms. HOOLEY. What does that say about underlying income, for example, and what happened to households who received the dividend in capital gains compared to households who relied primarily on income from their job?

Mr. ORSZAG. We are still trying to—we don't have a full-figure picture for what is causing the individual and corporate revenue increase. And I should say on the corporate side, obviously the share of the economy that goes to corporate profits, it is now at an exceptionally high level and has risen significantly and that is obviously a very important contributor to the corporate side. On the individual side, there are many hypotheses being put forward. One possibility for any given level for overall income, the larger the share of higher income household, the more revenue that would be collected because the overall tax system is progressive and that could be one cause of collecting more revenue than we projected based on economic growth alone. But we don't know that yet.

Mr. HOOLEY. Have the number of high household incomes risen? I mean, has that gone up significantly?

Mr. ORSZAG. There has been over the past now almost 20 years particularly rapid growth in incomes at the top end of the income distribution.

Ms. HOOLEY. And has real income growth been occurring for Americans at all income levels, or have we seen inequality increasing?

Mr. ORSZAG. Again, looking over a period of time since, for example, the mid to late 1970s, income gains have been much more rapid at the top end of the income distribution than the middle or the bottom. During the 1990s, what happened was that the middle versus the bottom tends to destabilize but the top relative to the middle continued to diverge.

Ms. HOOLEY. Okay. Is there anything that we need to do to change our income tax structure? I mean, as we get—this gap grows larger and larger between the high and the low, are we losing our middle class?

Mr. ORSZAG. Well, the changes that could or should be made to the tax system are obviously up to you, and we are just here to provide you with analysis with what different options could be, but you are in charge.

Ms. HOOLEY. Thank you.

Chairman SPRATT. Mr. Barrett.

Mr. BARRETT. Thank you, Dr. Orszag. Great to see you. You are becoming a regular fixture on this committee but thanks for coming today.

I wanted to head down a different direction, talk about mandatory spending because that is the elephant in the room that is breaking the bank. And I have got three questions. I want to throw them open to you and give you all the time to answer.

Number one, would it be plausible somehow to tie the growth of mandatory spending into some type of standard index like a CPI index? Question one.

Question two, we are looking at Medicare and I know this from personal experience because my mom and dad recently went on Medicare, and they are not paupers by any stretch of the imagination. They could pay some bills. Isn't it arguable that there are people out there that can afford private insurance that can't afford to pay for medical bills?

And number three, and I want to kind of tagteam on my ranking member's question. I did not—for the record, I did not vote for Schedule D. I thought it was too much for too many people, too expensive. But having said that, the one thing that is working in this process is the private sector that is driving some prices down. Is there some type of relationship between government intervention or government involvement in the health care market and the skyrocketing prices of health care, and that is my third one. I will turn them over to you.

Mr. ORSZAG. First, with regard to a standard index on the mandatory programs. By design, entitlement programs specify a set of criteria to meet and then the spending follows meeting anyone who qualifies and so it is difficult to reconcile that perspective with tying to a specific index. You might be able to come up with mechanisms that the criteria would evolve in response to changes—I will give you an example. In Medicare, there is something called the sustainable growth rate for physicians which something like that was attempted in which sort of aggregate spending was tried to be pinned down to index; that is, tied to MEI, basically an index kind of inflation.

And what we have seen there is that in fact this is an important point to know about the baseline, too. We assume that system will be fully implemented in the future and that will reduce payments to physicians relative to keeping up to overall health care activities by about $250 billion over the next 10 years. Every time this has been, or over the past few years when there has been a schedule reduction in physician payments because of that formula, the Congress has decided to undo the reduction, including last fall. So attempts to try to pile an index on to an entitlement program has not necessarily proven to be that successful, but there obviously are other possibilities that can be explored.

With regard to Medicare, as you know, part D, even though I gather you didn't vote for it, does involve some modest means testing within the Medicare program, which is new, and I know that there are various options that could be explored. I am not sure when you were talking about that in particular.

Mr. BARRETT. Just the Medicare system in general.

Mr. ORSZAG. That would be one way in reflecting the fact that some people can better afford health insurance coverage than others, at least the concept behind it. And I would be happy to talk about other options with you if I got a better sense of exactly what you were interested in.

And finally and returning to the question that Mr. Ryan asked, again we are still parsing out exactly what the causes of the lower bids and the lower cost for beneficiaries in Medicare part D are. There are two things. We have lower cost in part A and Medicaid which have different structures associated with them. So the good news on health care is not limited to part D.

And then secondly, that over a long period of time the cost growth in public programs, Medicare and Medicaid, has tended to track cost growth in the private sector and private health plans, and I think that is actually a very important point. We are very unlikely to be able to slow cost growth in Medicare and Medicaid without a commensurate slowing in overall health care costs in the private sector as a whole. I think at this point to answer your questions the systems are so interlocked that you can't separate one from the other, basically.

Mr. BARRETT. Thank you, Doctor.

Thank you, Mr. Chair.

Chairman SPRATT. Let's see. We have got Mr. Allen of Maine.

Mr. ALLEN. It is a pleasure to have you here and to hear you weave through this material as effectively as you have. I want to stay with this issue of Medicare for a moment, and in particular, I think we all run the risk sometimes of categorizing taking data and sort of plugging it into the views we already have. Some of us might say, well, the costs are still too high, whatever they are, because we believe that the negotiated prices would be lower. Some believe evidence of a reduced estimate is an indication that competition is working.

Now, I wanted to just run through—I would like to give you some thoughts on what the kinds of causes that I would hope you would consider if you would take another and deeper look at this. But it seems to me, first of all, we can get all caught up in changes, and part of what is going on it seems to me is that we have a better evidentiary basis for making estimates in the future once the plan has been running for a while.

Secondly, you mentioned part of the lower cost was because prescription drug plans and Medicare Advantage plans were coming in at a lower than anticipated rate while the Medicare Advantage plans are certainly under considerable amount of pressure because

MedPAC and others are saying they are overcharging their beneficiaries and that is creating a bit of some—well, attracting political interest on this side of the aisle, for sure.

You mentioned the different rates of take-up. But also it seems to me that there may be larger trends in drug prices, in consumer behavior going on. We may be sort of turning back away from or maybe—I mean, this is worth looking at anyway. There may be some consumers who are turning away from using as multiple prescription drugs and maybe the—simply the expiration of patents and the greater use of generics is having effects. Are there other factors that come to your mind that maybe have a bearing that you haven't mentioned in the course of your testimony so far today?

Mr. ORSZAG. I think you have touched upon the main ones, and that is why it is difficult to conclude or parse out just the fact of competition among the prescription drug plans as opposed to overall trends in health care, which in 2006 we did see a slower rate of growth than we had experienced previously.

Mr. ALLEN. Is this an area where the CBO might be looking at in further dependents when we go forward?

Mr. ORSZAG. We are very focused on health, yes.

Mr. ALLEN. I think what I would like to do there is a chart I would like to have put up on this one. In the course of your testimony, in the course of David Walker's testimony, we dealt with this question of tax cuts and whether they pay for themselves. And as I recall his testimony, he said only in the case of a dramatic drop in the marginal rate. You said something like a 90 percent or 80 percent to 50 percent when you might you see enough change in behavior. That is my recollection of his testimony.

Mr. ORSZAG. Can I comment on that because the first factor I mentioned is where you start really matters. Moving from 90 to 80 is a lot different than moving from 30 to 20.

Mr. ALLEN. I believe the U.S. Treasury recently came up with a study that suggested the long-term recovery of revenues from the 2001 and 2003 tax cuts was about in the neighborhood of 10 percent. Going forward——

Mr. ORSZAG. 10 percent of sort of the base costs.

Mr. ALLEN. Yeah. The 10 percent of the reduction in revenues from the tax cuts.

If you look at this chart, it seems pretty clear to me given the dates we are talking about in 2003 and 2004, revenues, as a percentage of the economy, fell to about 16½ percent. I think that is the lowest level in how many years? I mean, can you help me?

Mr. ORSZAG. That was the lowest level since some time in the 1950s.

Mr. ALLEN. To me that chart speaks very clearly that the drop, the dramatic drop in receipts as a percentage of the economy had a good deal to do, though I can't quantify it, with the 2001 and 2003 tax cuts, and therefore the deficits that resulted from that is driven in part by those two tax cuts. Do you have any further elaboration on this chart? Can you help explain to us that factor, the importance of that factor and any other factors that may have had a bearing on that dramatic drop in revenues?

Mr. ORSZAG. I would note that revenues do tend to decline in an economic downturn and increase during an economic upturn, and that is a normal cyclical pattern.

Mr. ALLEN. Has the CBO made any estimate yet to quantify how much of that decline in revenues was attributable to the tax cuts?

Mr. ORSZAG. Again, excluding the fact that the tax changes may have had on economic activities, we do sort of have a narrow accounting sense, have a figure of $221 billion in this year from the tax legislation that was passed in 2001.

Mr. ALLEN. By this year you mean?

Mr. ORSZAG. 2007, and that doesn't include debt service effects from the previous revenue effects.

Mr. ALLEN. Thank you very much.

Chairman SPRATT. Mr. Garrett.

Mr. GARRETT. Thank you, Doctor, for being with us. As I said, looking forward to the future testimony in further hearings.

I want to ask you a question first of all about baseline budgeting and supplementals. This committee has already discussed this in the past with regard to the global war on terror, and in the past we have used emergency supplementals repeatedly to fund that to the war effort. And also in this committee in the past we have discussed the problems with that, the lack of oversight and the reason we should rather at least give a given portion of that to go into regular order so the oversight committees can have the oversight of that. What can we do, if anything, if we move in that direction to have more—less supplementals and more on the global war on terror go through the regular order process? So too that it would not become part of the eventual continual baseline budget because, as you said, and we have heard in the past, some of these figures are not likely to continue on and on.

Mr. ORSZAG. Let me try to draw a distinction between the baseline and then the budget process that this committee plays a key role in.

With regard to the baseline, regardless of whether an appropriation is a regular one or supplemental, if it exists when we construct our baseline, it will be inflated out. So that distinction doesn't really matter for that purpose.

When you then go and set your appropriations totals as part of the budget process, you can make—this committee can make an adjustment in the budget resolution, you know, to take out a supplemental if you want to or put in additional money, and that is not a function of just our baseline.

Mr. GARRETT. It is going to be included in your baseline regardless of whether it is a supplemental or regardless whether it is a supplemental or if it is in regular order?

Mr. ORSZAG. As long as it is enacted.

Mr. GARRETT. Is there a way, realizing that some supplementals wouldn't be reoccurring, that you would have a way to take it out of your process so the numbers that you have would come out, would be a more realistic figure going forward, is my question.

Mr. ORSZAG. I understand. There are a set of scoring rules that basically govern this and that is what——

Mr. GARRETT. Who sets them and how do we change that?

Mr. ORSZAG. That was set by a law that has now expired, but there is an established norm there. What we try to do in situations like this is try to provide additional information where you could take that component back, add something in if you want it, and that is what we did with global war on terrorism activities in Table 15. There is an official baseline projection but then if you wanted to take the——

Mr. GARRETT. So the simple answer is we can change the process by your assumptions.

Mr. ORSZAG. This committee could change the baseline rules if you chose to.

Mr. GARRETT. The second conversation you had when you spoke to us previously, I know you made regard to your staff and the tremendous work that they will do in the future and what are some of the things that you might want to improve upon if you could? I think one of the things is response time for members' requests as far as scoring, what have you. Can you just comment on that?

Mr. ORSZAG. My understanding, over the past several years there has been a lot of attention paid to responding in a timely fashion to members' requests, and we are going to continue to do that, and if there are ever problems that arise I hope that you will get in touch with me directly about it. And I do want to join you in just noting what a tremendous staff CBO has. And also I am particularly pleased that Donald Marron is staying on as the Deputy Director, which will provide a lot of continuity and professionalism in the organization.

Mr. GARRETT. I am glad to hear you make this a priority for the Members.

And finally, we heard a lot of talk about when you make a tax cut on the dollar you may not see an increase for the dollar. Hearing that from the other side, somebody might believe that somebody is setting us up for down the road to see a tax increase potentially coming. Maybe not. But can you turn that question around, maybe, and that is to say for every tax dollar increase that goes can a particular American family necessarily see a dollar increase of services that they get from the government? Or to bring it home to my State in New Jersey where we get $0.57 back on the dollar, so every dollar New Jersey families sends to Washington, we get $0.57 back in overall government services. If we were to increase taxes in my State of New Jersey or a typical American family in New Jersey by a dollar, can you tell us whether that family in the State of New Jersey would see a commensurate $1 increase from the service of the Federal Government for the tax increase?

Mr. ORSZAG. What I would say is especially over the long term as a nation we need to pay for our governmental services, and it is very difficult to parse on an individual family-by-family basis.

Mr. GARRETT. How about a state-by-state basis like mine that has only been getting $0.57?

Mr. ORSZAG. It depends on how you do the calculations. How do you compute the benefit to New Jersey of having an effective defense of the entire Nation. You can do a sort of accounting analysis, which people have done, and I am sure that is where those numbers come from. But it is very difficult to take into account things that benefit the Nation as a whole and how you sort of parse that out on a state-by-state basis. So I would just say that kind of analysis is very difficult to do. It is difficult to do.

Mr. GARRETT. Okay. Thank you.

Chairman SPRATT. Mr. McGovern of Massachusetts. Not here.

Mr. Scott of Virginia.

Mr. SCOTT. Could we get the chart up?

We keep hearing about this gang busting economy and the jobs that are being created. We wanted to show this chart so that people would know what we are talking about. This is the average number of jobs created over the administration for the Clinton administration and the Bush administration, and everybody is bragging about how well this administration is doing so we just wanted to put that up. I understand the numbers. Now this is the average over 6 years. The more recent numbers are up to about 150,000 in some recent months, which would be a little below average for the previous administration. We just want that up there so people will know what—put things in perspective.

This year's deficit, as I understand, it doesn't include the expected supplemental for the war?

Mr. ORSZAG. That is correct.

Mr. SCOTT. Does it include any other supplementals? We understand the FBI has complained that they are going to have to fire FBI agents and the Department of Justice might have to get rid of prison guards if they don't get supps. If that supplemental occurs, that is not a part of this either. That is something that would have to be added on, right?

Mr. ORSZAG. The 2007 number comes very close to the continuing resolution limit, and to the extent you wind up with domestic appropriations that affect that, that would also affect the budget outcome.

Mr. SCOTT. I agree with the gentleman from North Carolina that I would expect some people to lose their Medicare prescription drug coverage in the future. It has been a very attractive benefit but since people can get it on its own, it is not as compelling a benefit as it has been in the past. So we have had—we would have to keep an eye on that number. But is the lower cost benefits because of the lower number of the people or because of the lower cost per person?

Mr. ORSZAG. It is mostly because of the lower cost per person. So out of the $265 billion reduction, a little bit more than $200 billion is because of the lower cost per person.

Mr. SCOTT. The emergency costs like hurricanes, like we didn't have many hurricanes this year. You are going to project out a lower cost than the year before when we had Katrina and Rita and everything else. Does it make sense to do it that way for emergencies, which you don't know what they are going to be, wouldn't a 5-year average make a lot more sense than the ups and downs of each year as to what might be expected?

Mr. ORSZAG. First with regard to programs that involve spending in emergency programs like insurance programs, we do incorporate some estimate of the likelihood in doing the projections. But with regard to domestic spending, that is one time. Again, the scoring rules suggest that we just take whatever has been enacted and inflate that forward and not try to guess what you all will do in future years in that category.

Mr. SCOTT. PAYGO. Under the PAYGO rules, we have to pay for the extension of tax cuts.

Mr. ORSZAG. Under the pay-as-you-go rules that apply in both the House and the Senate, a revenue, yeah. Basically extending the tax provisions past their scheduled sunset have to—would have to be offset through some other mechanism unless you waive the requirement.

Mr. SCOTT. And we have heard about the fact that we have got record revenues, the nominal amount is higher. How many years in the last—since the Great Depression has the nominal amounts of revenues actually gone down?

Mr. ORSZAG. I don't have that number off the top of my head but the nominal level going down is relatively rare and would typically be associated with a recession.

Mr. SCOTT. Would it surprise you if somebody told you that only after this administration's tax cuts for a couple of years, the normal years since the Great Depression, that it actually went down?

Mr. ORSZAG. It wouldn't surprise me if someone said that. Whether if it was true or not, I would want to check that.

Mr. SCOTT. Could you get us the information? I think there are a couple of times it may have gone down other than this administration.

Mr. ORSZAG. I would think after World War II there would have been a decline.

Mr. SCOTT. If you would check and give us that information so we will have it for the next meeting.

Thank you, Mr. Chairman.

[The information follows:]

CBO RESPONSE TO MR. SCOTT

Since the Great Depression (and through 2006), revenues have declined from year to year 14 times.

Chairman SPRATT. Thank you, Mr. Scott.

Mr. Simpson.

Mr. SIMPSON. Thank you, Mr. Chairman. Do you have any more? I would be happy to yield.

Mr. SCOTT. When he gets the numbers, that would be best when he gets the numbers.

Mr. SIMPSON. You mentioned you said instructed to construct the baseline. Who instructs you to construct the baseline? How do you decide what decisions you make? Are those in statute somewhere, or are they just policy that CBO works up?

Mr. ORSZAG. They were contained in section 257 in budget legislation. That section expired but there has now been a long history of applying the rules in a particular way and we continue to follow that long history of baseline construction.

Mr. SIMPSON. So it is up to you to determine what economic assumptions you are going to use when different policies are enacted?

Mr. ORSZAG. I suppose it is our responsibility to come up with economic assumptions but the baseline concept is up to the Congress and in particular up to the budget committees.

Mr. SIMPSON. I got the impression that you use supplementals. You carry forward supplementals as continued spending.

Mr. ORSZAG. That is correct.

Mr. SIMPSON. But by definition, aren't those supposed to be emergency supplementals, one-time spending even though we go more and more into that arena where we shouldn't and we should get back to where supplementals are true emergencies. How can you project carrying forward the cost of Hurricane Katrina?

Mr. ORSZAG. In this baseline we don't, but I think the broader point with regard to the discretionary part of the budget, a little bit above a third of the budget that you all decide upon year by year, the baseline is not really a prediction of what you are going to do in the future but rather just some benchmark that inflates the existing year forward period and it doesn't try to predict what you are going to do on Homeland Security spending in 2010.

Mr. SIMPSON. But it bases those assumptions on what we have done in the past?

Mr. ORSZAG. That is correct. With regard to that part of the budget, it is a very simple rule.

Mr. SIMPSON. But using supplementals in projecting that would seem to me to throw off the future projections.

Mr. ORSZAG. It could. On the other hand, if you look at the pattern of discretionary spending growth over a long period of time, our assumption in the baseline that it just keeps pace with inflation goes another direction because over a longer period of time discretionary spending has tried to rise more rapidly than that—than just keeping pace with inflation.

Mr. SIMPSON. When you look at the cost of a tax cut, do you look at the lost revenue that you would be assuming that the economic activity remain the same and that you would lose that much revenue because of a lower tax rate?

Mr. ORSZAG. Again, the Joint Committee on Taxation is responsible for revenue scoring, and they will take into account microeconomic responses. So the fact that people may shift the form of compensation in response to tax changes but not macroeconomic effects, we have in the past taken those macroeconomic effects into account in dynamic analysis papers that we have done outside of the formal scoring process. And I think the distinction is important. In dynamic scoring, you have to pick a certain number. That puts a lot of pressure on organizations like CBO to pick the parameter values and small changes and assumptions can bring changes in outcomes. So in a dynamic analysis, we can present lots of different combinations to give you some sense of not only the likely magnitudes but how they vary on different assumptions, and that is a luxury. That is not possible in a single scoring exercise.

Mr. SIMPSON. I guess when we reduced the capital gains rate we had to estimate that it was going to cost the Federal Treasury when everyone knows that it was going to bring in more revenue and in fact it did bring in more, substantially more revenue.

Mr. ORSZAG. There are two effects. The capital gains tax rate. There could be a timing effect with more realizations and also an effect in revenue in the very short term and the very longer term effect. All of the analyses I have seen from Greg Mankiw and others suggest that tax changes of that type when you reduce the tax rate, the revenue is reduced over the long term but not by as much as the effect itself because there is some offsetting impact on economic activity and on capital gains realizations. That offset is not—given the tax structure of the United States is typically not large enough to offset the cost.

Mr. SIMPSON. Is that true in every tax category?

Mr. ORSZAG. It will depend on where you start, and I don't want to say in every category but there may be exceptions, but in general, given the existing tax structure that we have in the United States and with the level of rates that we have in the United States, it is generally true.

Chairman SPRATT. Mr. Moore.

Mr. MOORE. Thank you, Dr. Orszag, for being here.

The Federal deficit now stands in excess of $8.7 trillion; is that correct?

Mr. ORSZAG. That is the gross Federal debt.

Mr. MOORE. $8.7 trillion; is that correct, and that is projected to be the gross Federal debt, $8.9 trillion, by the end of this year; is that also correct?

Mr. ORSZAG. We project gross Federal debt to be $8.9 trillion by the end of fiscal year 2007.

Mr. MOORE. And the gross Federal debt was $5.6 trillion in January of 2001?

Mr. ORSZAG. It may be correct. It may take me—but for the sake of argument, that would be correct.

Mr. MOORE. That would be an increase of more than $3 trillion in 3 years?

Mr. ORSZAG. Assuming that your original number was correct. There are—obviously has been an increase in Federal debt whether it is on a gross basis or public held basis of a few trillion dollars over the past several years.

Mr. MOORE. How much of our national debt now is held by foreign nations, Doctor?

Mr. ORSZAG. Something like 40 percent now.

Mr. MOORE. What would the number be?

Mr. ORSZAG. We have a section in the report that talks about foreign ownership out of the publicly held debt, so it is roughly 40 percent. I could get you—between 40 and 45 percent. We will get you the exact number.

[The information follows:]

CBO RESPONSE TO MR. MOORE

At the end of fiscal year 2006, foreign and international held debt totaled $1.933 trillion—about 40 percent of debt held by the public.[1]

Mr. MOORE. While we are talking here, can somebody back there get you the number for the increase in the past 6 years of our debt?

Mr. ORSZAG. [Nods head.]

Mr. MOORE. Thank you.

Do we even have a ballpark figure for what the foreign debt is right now?

[1] Source: U.S. Treasury.

Mr. ORSZAG. The foreign held debt of the United States is roughly—the public debt that is owned by foreigners is roughly $2 trillion.

Mr. MOORE. What would be the effect if foreign nations decided they didn't want to hold their debt for whatever reason anymore? What would be the effect in our country?

Mr. ORSZAG. It would depend upon the response of other players in financial markets. If there were significant change in the willingness for foreign official entities and other investors to hold other publicly held debt, one would expect some adjustment process and depending on the speed of that withdrawal and the response of other financial market participants, it could either go smoothly or abruptly.

Mr. MOORE. Could it have any impact on our interest rates in this country?

Mr. ORSZAG. It potentially could, yes.

Mr. MOORE. In what respect? Good or bad impact?

Mr. ORSZAG. Once would anticipate there would be some upward pressure on interest rates and the extent of that upward pressure would depend on the factors I was just mentioning.

Mr. MOORE. Because people would have to, in this country, would have to finance the debt, and there would be competition for the funds available?

Mr. ORSZAG. Having more people sell public debt would drive the price down and the interest rate on that debt up.

Mr. MOORE. How much was the interest in dollar figures on our national debt last year, if you know?

Mr. ORSZAG. 200 and—a little above—I was going to say 220 billion. $227 billion.

Mr. MOORE. Do you have an estimate for what the interest would be on that debt this year?

Mr. ORSZAG. 235.

Mr. MOORE. Billion dollars.

Mr. ORSZAG. Correct.

Mr. MOORE. And the gross is over $400 billion?

Mr. ORSZAG. That was net interest on publicly held debt that I was giving.

Mr. MOORE. Who is going to end up paying for this?

Mr. ORSZAG. Those outlays are part of the Federal budget and ultimately will have to be financed either through reductions in other spending or increases in revenue.

Mr. MOORE. Or passed along to our children and grandchildren to pay it.

Mr. ORSZAG. But ultimately that is not sustainable if one can't just continue to pass more debt on to future generations because ultimately you would have a debt spiral that——

Mr. MOORE. We are passing substantial debt on to our children and my seven grandchildren right now; isn't that correct?

Mr. ORSZAG. We as a nation are not saving very much. That means we are not passing on as much capital to future generations as we could. I think we do need to remark upon the low level of national savings in the United States, which has one of two consequences. Either it means we will invest very little in the United

States or we have to borrow substantial amounts from foreigners. In recent years we are mostly doing the latter.

Mr. MOORE. Thank you.

Chairman SPRATT. Mr. Lungren.

Mr. LUNGREN. Thank you, Mr. Chairman.

Doctor, it is nice to see you here. I am not an economist and I am not even a country lawyer. I am just a plain old lawyer.

Mr. ORSZAG. Boy, am I getting nervous.

Mr. LUNGREN. But I am not a tax elixir, as someone suggested over there and restated they meant tax cut elixir, suggesting that is what we are looking for over here.

My problem is I come from a different perspective having been gone for 16 years. I was here in the 1970s and 1980s. Do you have a figure of what the average unemployment rate was during the 1970s?

Mr. ORSZAG. I don't have it off the top of my head. We can get it for you. It was higher than it was today.

Mr. LUNGREN. The interest rate.

Mr. ORSZAG. Higher than what it is today.

[The information follows:]

CBO RESPONSE TO MR. LUNGREN

The average unemployment rate from fiscal years 1970–1979 was 6.1 percent. From 1980 through 1989, the average rate was 7.3 percent.

Mr. LUNGREN. The tax rates in the 1970s.

Mr. ORSZAG. Higher than it is today.

Mr. LUNGREN. Is there any impact on the employment rate as a result of lower tax rates helping stimulate a private economy?

Mr. ORSZAG. I think it is very difficult to draw that connection. For example, someone put up a chart earlier about growth rates during the 1990s when tax rates were also—growth—job growth rates were higher than they were.

Mr. LUNGREN. But the tax rates were significantly lower than they were in the 1970s?

Mr. ORSZAG. That is correct.

Mr. LUNGREN. There was a chart put up there I think when Mr. Allen was speaking, and it talked about the dip that we had in receipts, that we had in receipts and apparently the graph didn't take into consideration your testimony because it showed a leveling off of receipts below 18 percent, about 17.5 or 6 percent. As I understand your testimony, revenues measured as a percentage of GDP have grown in the last several years. And I believe you state here increasing from 16.3 percent in 2004 to 17.6 percent in 2005 to 18.4 percent in 2006 and that the last figure is, quote, slightly higher than the average, 18.2 percent of the past 40 years; is that correct?

Mr. ORSZAG. That is correct.

Mr. LUNGREN. So we are now in the range of receipts as a percentage of GDP that has prevailed over the last 40 years?

Mr. ORSZAG. That is correct.

Mr. LUNGREN. Even though the tax rates are significantly less than they were in the first 20 of those 40 years?

Mr. ORSZAG. That is correct also.

Mr. LUNGREN. How much would it cost to fill the donut hole?

Mr. ORSZAG. Now that we have information on actual enrollment in part D, we will be providing an updated estimate of that in the near future.

Mr. LUNGREN. Do you have any range of what we are talking about there?

Mr. ORSZAG. Rather than give you an incorrect number, if I would be allowed to——

Mr. LUNGREN. Do you have a suspicion it will be an insignificant number?

Mr. ORSZAG. It is clearly a significant number.

Mr. LUNGREN. When you talk about the employment participation rate, and you project that forward, does that consider any changes in immigration policy?

Mr. ORSZAG. That does not consider a change in immigration policy. It assumes roughly a million people per year in net immigration and that is new entrants minus people who leave.

Mr. LUNGREN. Isn't it a fact without immigration at the levels we now have, legal immigration, let us just now talk about that, we would have an even worse situation in terms of being able to sustain the Medicare/Medicaid/Social Security that we have built into the system as we look forward?

Mr. ORSZAG. Or another way of putting it is higher immigration can help a bit but the effect is not as large as one would initially think. And it depends in part on the skill mix of people coming in. The reason is that you get more revenue, but for example under Social Security you also then have higher benefits based on the work history of immigrants.

Mr. LUNGREN. I thought one of the simple ways of looking at our Social Security problem is the number of people working versus the number of people who qualify for Social Security versus what happened in the earlier years. And if we had declining birth rates such that we do not have more people coming into the work force over time, you build yourself into a tremendous problem such as we see in Europe now and that without some continuing immigration, such as we have seen in this country traditionally, we have become another Europe.

Mr. ORSZAG. And again, the effect, though, tends to be relatively modest because there is some effect on benefits and it really does also depend on the skill mix. For example, if low wage immigrants are disproportionately the increment, then because the Social Security benefit formula is progressive, the net effect is not as large as if they are high wage immigrants. Greatly disproportionate.

Mr. LUNGREN. Thank you very much.

Chairman SPRATT. Mr. Cooper.

Mr. COOPER. Thank you, Mr. Chairman.

Well, according to CBO, the New England Patriots are in the Super Bowl this weekend because under this sort of baseline analysis, when you only look at the past, the Patriots look mighty good. In fact, they looked really good in the first and second quarter of the playoff game. But then everything changed.

So my point is I am very worried that as interesting as this academic exercise is, it really tells us very little about the future. Fortunately both parties have reason to question the validity of the baseline. You don't want to see all of the tax cuts revealed. We don't want to see other things happen. But when, for example, as you said earlier in your testimony, just keeping the level of paying with AMT, that would cost us a trillion dollars. That is not reflected in these numbers. That shows you the extreme variability of the analysis.

It is interesting to me, too, what you said that the requirement that CBO do this is under an expired law that lives on as informal practice. I am not faulting you or CBO. I think you have done as well as could be done given this constraint. But this is a very poor way of looking at the future. The President bragged in the State of the Union Address he would have a balanced budget in 5 years. According to your numbers, if we do nothing, if Congress ceases to exist for 5 years, we would have a balanced budget in 5 years. So, you know, the President has basically stated as a claim, you know, what you say we would achieve on automatic pilot.

My purpose is to not fault CBO or the methodology. I just want realism in the numbers and to me we are not achieving that with this exercise. So I would like to work with you in the coming months to figure out a better way to come up with projecting into the future so that we have a more realistic handle on things.

Can you think of any ways right now that we could do this?

Mr. ORSZAG. Having grown up in Massachusetts, I am still having to get over your first comments.

There are a lot of different ways of trying to construct a baseline and obviously I think having the budget committees revisit those baseline rules to explore whether some updates or tweaks would make sense and would be welcomed. But I would say there has to be a core principle behind the combination of the baseline and the scoring rules which is that the cost of a policy change shows up at some point. So it shows up either when you score the provision and then it can be carried forward in the baseline or it shows up—the full cost has to show up at some point, and we don't want a situation in which costs just disappear from the combination of the baseline and the scoring process.

So, for example, one can imagine a system in which a tax change that was officially temporary would be scored as permanent. So an AMT change for 1 year would be scored as permanent and then from thereafter that would be included in the baseline. That may or may not lead to more clarity about future budgetary outcomes, but I think what is important is that the costs show up at some point. The current system achieves that objective and any alternative system needs to achieve that objective also even though there are different ways of achieving it.

Mr. COOPER. If you look at your analysis under Medicare you assume that we are going to cut physician's pay 10 percent next year. That is wildly unrealistic if you look at congressional behavior in the last 4 years. We have always saved the doctors at the last minute. So many of our assumptions seem to be based on premises like this, and by the way, just freezing doctor reimbursement under Medicare would cost $5 trillion. That is not giving the docs a pay raise. That is freezing reimbursement because the formula under BBA 97 is skewed to expect a 30 percent cut in finance pay. Who thinks that is going to happen? So I am just worried that this is a little bit like the medieval argument how many angels can dance on the head of a pin.

In my 30 remaining seconds, the gross interest that America had to spend last year to service its debt was $406 billion. That is on page 74 of your analysis, and you point out very helpfully that the rate of growth of interest, spending growth, interest spending is four times faster than the rate of increase for the non-interest spending. That should alarm the members of this committee. If you look at the CR we will pass this week, that is, what, $463 billion we are going to spend, 406 billion just on interest. So that is the tax you can't repeal. That is a tax that can never go away unless you bill budget surpluses and that is the tax that is growing at a rate four times faster than all other spending. So I would urge my colleagues to focus on pages 71 through 74 of your analysis because while we can't trust the future necessarily, we can trust the historical numbers.

Mr. ORSZAG. If I could make two comments, Mr. Chairman. The first is obviously the pressure that is put on the baseline process and then relatedly the scoring process when provisions are wildly anticipated to be continued, are written in official law as being temporary, and you could perhaps include the sustainable growth rate formula under Medicare in that and perhaps include the revenue provisions in that also. I know you know this, but I think it is worth pointing out that that creates awkwardness regardless of how either we are going to ignore the official law or not ignore it but reflect it in a different way, or we are going to have baselines like the one that we presented to you today that many observers may not believe are realistic.

And just very briefly since I have been asked and I know there is interest in gross debt, since I was able to find it, the publicly held debt, that did rise from $3.3 trillion in 2001, at the end of 2001, to 4.8 trillion at the end of 2006.

Mr. COOPER. Thank you.

Chairman SPRATT. Mr. Bonner.

Mr. BONNER. Doctor, I would like to follow my colleague from Tennessee in hoping for realism in the numbers. I guess I would like to get your views on the realism and the facts. Many people who run for Congress or other jobs in life made campaign promises and then when we catch that car, they have to try to reconcile their promises with the reality of the job. In your view, if we allow the tax cuts of 2001 and 2003 to expire, is that in effect a tax cut or a tax hike for those who promised that they would never raise taxes?

Mr. ORSZAG. I am not going to get into the semantics game. If they allow those provisions to expire, the revenues would be higher if they did not expire.

Mr. BONNER. Okay. Many people outside of this body back in our communities and our States sometimes believe that many of us inside this body have done a very poor job of handling the exploding growth in entitlements. What in your view are some of the principal factors in the structure of the entitlement programs that have fostered such a rapid growth and, in general, what kinds of options are available to us in Congress to alter the structure of these programs to make them more sustainable for the long term?

Mr. ORSZAG. With regard to the first question, the ongoing increases in Medicare, Medicaid and Social Security, particularly the first two of those where most of the projected increase occurs, reflects both ongoing health care cost growth, which exceeds economic growth. Over the last 40 years, health care costs per beneficiary have grown 2.5 percentage points a factor than economic growth.

Then, secondarily, the aging of the population. So, as the population ages, costs go up in both Medicare—in both the health programs and in Social Security.

In terms of options for restraining the emerging imbalances in our different entitlement programs in some sense it is very simple. Spending is projected to exceed revenue, so you need some combination of lower spending and higher revenue. The combination is really up to you, but the precise details are obviously what is important, and there again I think it is really up to the Congress and to the President to decide the best way forward.

What I would say is that, on the health care side, as—returning to the discussion we had before, there is at least some opportunity for constraining cost growth, spending growth, in a way that neither impairs innovation nor harms health, which is the ultimate objective of those programs, and that is, in a sense, a central—I think should be a central focus of effort, to find the ways in which we can take cost growth out of the health system without impairing health or innovation.

Mr. BONNER. Sticking with health and going back to my previous question about people who run for office making campaign promises, we have a Presidential election coming up in 2 years, and some of the candidates are already promising, one in particular, every American should have universal health care within 6 years.

Since health care is such a dominant part of the topic today, can you envision, as a noted and respected economist, a scenario where we can afford to provide universal health coverage for all Americans and, at the same time, get a handle on the growth of this very explosive part of our economy?

Mr. ORSZAG. I am told that when a health economist died and went to heaven, St. Peter let him ask one question. He said, will we have universal health insurance? And St. Peter said, yes, but not in my lifetime.

I think that, obviously, there are ways of getting to universal health insurance systems; and evaluating the cost is something that we are very actively engaged in. I wouldn't want to characterize the costs as being either insignificant or catastrophic. It depends in part on precisely what you do; and we are seeing different models emerging from the States, from Massachusetts, California and others, in terms of how one could, at the State level, move to a more universal coverage.

Mr. BONNER. Mr. Chairman, if there is no objection, my colleague—our colleague Mr. Garrett had one other question. Could I give the balance of my time to Mr. Garrett?

Chairman SPRATT. Sure.

Mr. GARRETT. I would like to join the gentleman from Tennessee to be so willing to raise the issue that you raise as far as reforming. This question goes on the baseline issue. Correct me if I am wrong. If you are looking at a tax on the law on the books that is set to expire in x number of years, 3 or 4 years, your baseline will assume that it will end at that time for your projections going forward?

Mr. ORSZAG. With one caveat, which is that revenues that are dedicated to particular trust funds are assumed to continue. But, generally, yes.

Mr. GARRETT. And, secondly, you are looking at a spending program that is authorized and the authorization is going to expire in X—the same number of years, you will assume what in that case, on the spending side of the equation?

Mr. ORSZAG. Generally, that they are continued, but, again, there are exceptions on that side, also.

Mr. GARRETT. Can you explain why you treat one as continuing even though the law has expired and the other one you treat differently?

Mr. ORSZAG. Again, I think the key concept is that the costs show up at some point. So, for example, SCHIP is coming up for reauthorization. When that program is scored, even if the reauthorization only applies for 5 years, we will assume that those changes continue out and score those changes. So the costs are paid for at some point. In that case, you know, when the reauthorization occurs; and then those higher levels would be carried out and incorporated into a future baseline.

One could do the same thing on the revenue side. So, for example, one could say, you do a 1-year AMT fix, we are going to score that as a 10-year change, and then that will be incorporated into the baseline thereafter. The key thing is that the costs show up at some point. The existing system basically achieves that.

There are others—and we would look forward to working with you on it—that could achieve it also and that might address some of the at least perceived asymmetries that you have touched upon.

Mr. GARRETT. Thank you again. I appreciate working with the gentleman on that.

Chairman SPRATT. Thank you, Mr. Garrett.

Mr. Berry.

Mr. BERRY. Thank you, Mr. Chairman.

Dr. Orszag, God bless you for taking on this job; and we do appreciate very much you being here.

Mr. ORSZAG. Thank you.

Mr. BERRY. You say that we are going to save or have $265 billion less spent on the Medicare Part D over the next 10 years than we had anticipated. That is less money that the government is going to spend?

Mr. ORSZAG. Correct.

Mr. BERRY. Do you have any information about how that impacts—how our seniors are impacted and the people who participate in the program? Are they spending more or less or—and also the providers?

Mr. ORSZAG. There would be a corresponding—well, we need to parse a couple of the pieces. The cost per beneficiary piece, which is the majority of the change resulting in lower government spending, would also have beneficial consequences for beneficiaries. In other words, as the bids come in from the prescription drug plans at lower amounts, there can be benefits for consumers, also. Correspondingly, there is lower income to the plans, but that is because they have figured out that they can offer the plans at lower rates and still be profitable.

Mr. BERRY. Right. The anecdotal information I have is our concern is the seniors that are involved in these plans are actually getting to be worse off because their copays are going up, their premiums are going up, and the actual service that they have available is not—actually not as good, even though they are offering more plans. The plans are making money, but the pharmacies are not making money, and the seniors are having more difficulty getting their medicine.

We have absolutely just an onslaught of seniors coming to our office asking for help. So I would love to see some information on that, if you have it available.

Mr. ORSZAG. Sure. Let me just actually note—there is one discussion about cost, there is another about confusion and complexity, and especially at the beginning part of this program there did seem to be concerns about how complicated some of the choices were for senior citizens, for beneficiaries to make.

Mr. BERRY. Right.

The other comment I would have is not so much a question. I guess in the end it will be a question, but, since 1981, I have been told over and over again, you know, if you just cut taxes, that this wonderful economy is just going to bubble up out of the ground and everything is just going to be absolutely magnificent for the United States of America; and we did that as a Nation as a matter of public policy.

Then I remember so well a fellow named Daniels, who was Director of OMB at that time, in April of 2001 coming to the Blue Dogs and explaining to us that, if we just did that, that the great danger that it presented to the country was that we would pay off all the debt and there wouldn't be a safe place for people to invest their money because you couldn't buy a U.S. Treasury bond. And that not only did we have a projected $5 trillion surplus at that time, but it would grow and compound itself to the point where we would just be run over with money.

It appears to me, you know, I don't think you have got to be all broke out in brilliance to just see if we keep doing what we are doing that we can in not too distant in the future, not too far away, we can bankrupt the Nation and hand over to our children and grandchildren a God-awful situation.

I agree with my colleague from Tennessee. We could have one little segment here of these numbers—we have got your baseline, then we have got the on-budget, and then we have got the off-budget. And just pick one, and you can come up with a scenario that would be absolutely wonderful to present to the American people, but, in the end, we owe this money. We are borrowing more money all the time, and when you cut taxes and borrow the money to pay for it and actually increase spending, it appears to me that that would also stimulate the economy on the short term in an irresponsible way.

I don't know if any of this that I am saying makes any sense to you. I know you are a lot smarter than I am. I never would question that.

Mr. ORSZAG. I don't know about that.

Mr. BERRY. But at some point if we are going to be a successful Nation, don't we have to change what we are doing and be more responsible about it and deal with health care costs and be responsible about taxes and expenditures?

Mr. ORSZAG. I think there is no question that there is a very broad consensus among analysts, economists and others that constraining health care cost growth and, in particular, raising national savings would both be beneficial over the long term for our economic performance.

Mr. BERRY. Thank you.

Chairman SPRATT. Mr. Conaway.

Mr. CONAWAY. Thank you, Mr. Chairman.

Doctor, thanks for being here. I appreciate earlier the conversations, your hesitation to use the word "pay" for tax cuts. I am going to count it, and earners, wage earners and businesses pay taxes. Governments collect it. So we don't pay for tax cuts in that traditional term, and I appreciate you not using that phrase any more often than we are all subject to using it. We all use adjectives in an attempt to try to influence, to try to move people one direction or the other.

My good colleague put up a slide earlier on job growth and admitted during his presentation that it was inaccurate, but he put it up, I guess, to try to influence it. I guess at some point in time it was better than it is right now.

I would caution you in your reports for use of adjectives. Under economic outlook, you talk about post-solid gains, which is a positive adjective—this is under page five, just to make sure you know I read all the way to the end of your deal. Just be careful with your use of adjectives as you talk about things going up and things going down, because it is always in the eye of the beholder as to which is important.

I agree with my colleague from Tennessee that the projections are wrong on their face most times. We can project next quarter. We can project pretty good this year. Who knows? The last 2 years, the other side has—and Mr. Berry did earlier—reflected back on the projections from the late 1990s which projected trillion dollar surpluses. Those were inaccurate at the time they were done, but yet we seem to have to cling to them as if they have some authority today. Yet they really don't because the circumstances on which those projections were based didn't turn out to be the reality we faced. It is not good/bad. It is just the way it is, and to continue to use those dated projections as some sort of an argument to support arguments I think is misplaced. So I agree with Mr. Cooper in his comments that we have got to be careful in how we use those.

Broad numbers, we are currently spending about 20 percent of GDP on the Federal budget. Federal spending projections at CBO and other places show that in the next 50 years or 45 years growing close to 50 percent of GDP. My comment is that, at 50 percent, you know, free market enterprise or our system of government, it is more of a threat to our way of life at that level than at almost any other thing we have got going on these days.

In your judgment—you know, I don't think the Federal Government take half, the central government take half, and you and I and our families take the other half and continue to grow and prosper and provide the opportunities we all want to hand off to our grandkids. Where in your mind is the crossover? I think 20 percent is the gag threshold now. But where in your mind is Federal spending and related revenues—if we are going to have a balanced budget, Federal spending as a percentage of GDP, where do you think it is unsustainable from a free market system so that we then have to go to some other kind of an economic way of life that would sustain that continued growth? Where is that number in your mind?

Mr. ORSZAG. I don't think that there is a single number, in part because how you raise revenue affects the economic implications. So, you know, corporate income tax is different from an individual income tax that is different from a value-added tax. And we see a variety of experiences in European countries. In the Scandinavian countries, there has been relatively good overall economic performance with higher revenue-to-GDP ratios, but that partially reflects the mix of revenue that they have.

Mr. CONAWAY. Did it also reflect their—okay, Scandinavian country with an economy of where on the scale against the United States? The United States is the largest economy in the world. Scandinavian country——

Mr. ORSZAG. Tends to be small.

Mr. CONAWAY. Where? Less than some of our States, I would argue.

Mr. ORSZAG. Certainly less than California, yeah.

Mr. CONAWAY. I am curious, being able to look at small models like that and projecting that onto an economy that is as large as the one we have here, if that is accurate.

Mr. ORSZAG. Oh, I didn't mean to imply any——

Mr. CONAWAY. Sweden, we could stand 70 percent rates here and spend that.

Mr. ORSZAG. No, I don't mean to imply that at all. All I was saying is that there are countries that have relatively high revenue-to-GDP ratios that still experience relatively rapid growth, but they have particular mixes of taxes, not to say that that would work or it has any implications for the United States but just to say that the mix of revenue does matter.

Mr. CONAWAY. All right. So you think we can sustain a 50 percent of GDP——

Mr. ORSZAG. I didn't say that.

Mr. CONAWAY [continuing]. On the largest economy in the world, is that your statement?

Mr. ORSZAG. No.

Mr. CONAWAY. Okay. We are at 20 now. We are muddling along ever so poorly. Give me a range. Where do you think—is it 30 percent, 35, 40? Where is it—we hit the wall, if you run a marathon, it is at 20 miles. Where is it that we hit the wall in this? I can't hold you to this, obviously. But——

Mr. ORSZAG. It all depends; and, as a marathon runner, I know from experience that where you hit the wall, if you do, depends on what kind of——

Mr. CONAWAY. So your testimony is, Peter, 50 percent will work if you have the right mix of tax collection scheme.

Mr. ORSZAG. No. I do think at 50 percent of GDP—and I don't want to be pinned down to a specific number, but at 50 percent of GDP there would be significant economic consequences from raising that much revenue as a share of GDP.

Mr. CONAWAY. Okay. Just—so, in other words, reducing spending and related revenues—I mean, somewhere in there we have got a wreck.

Mr. ORSZAG. Again, this goes back to where why I think we need to bend that health care curve. But, yes, trying to meet the entire projected increase in health care spending solely on the revenue side——

Mr. CONAWAY. Government spending.

Mr. ORSZAG. Government spending, but it is mostly health.

Mr. CONAWAY. Yeah. But we still have to pay for national defense and all those other kinds of things.

Mr. ORSZAG. Would involve significant adverse economic consequences ultimately.

Mr. CONAWAY. Thank you, Mr. Chairman.

Chairman SPRATT. For her patience and forbearance, the gentlelady from Connecticut, Ms. DeLauro.

Ms. DELAURO. I thank the chairman, and I want to say thank you to Dr Orszag. I appreciate the content of your testimony, the breadth of knowledge and the clarity with which you address the issues.

Let me move to a different topic. I don't think it has been discussed, at least I haven't heard it since I have been sitting here; and it may be that because I have just become the Chair of the Agriculture Subcommittee of Appropriations that I am going to move in the direction of farm programs.

Mr. ORSZAG. Okay.

Ms. DELAURO. And just a couple questions in this area with this preface. As I understand it, and just that in terms of the 2007 baseline, what CBO has done is to revise its cost estimate for the main farm support programs from what was an August, 2006, forecast. The areas of change is in the commodity price programs, mandatory conservative programs, crop insurance.

In the commodity price support program, again my understanding is is that there has been about a $30.8 billion drop in the forecast. Let me just—the drop projected essentially because of CBO's forecast for continued high crop prices over the long term that are substantially above the historic average in the area of corn and wheat and soybeans, and one of the, again, premises of this effort is the strong demand for corn-based ethanol.

The question is—two questions—is what is the budget impact if crop prices do not maintain historically high levels? And in terms of past projections in a historical context here, what happened in the Congress's reauthorization of the 1996 Farm Bill? Because this will impact the discussion over the farm bill which is coming up for reauthorization.

Under the estimates for the 1996 bill, how long did CBO project crop prices to remain high? How long did it take until the agricultural market shifted the crop prices and crop prices fell? What were the results in terms of the Federal farm support costs?

Mr. ORSZAG. So, first, with regard to the change in projections——

Ms. DELAURO. What happens if we do not maintain these historically high?

Mr. ORSZAG. If you have lower crop prices, that drives up the cost of the price support programs, and it also drives up the cost of—sorry—if we had lower prices, the price support programs go up in cost, and I think what we have seen in this baseline relative to August is, for example, higher corn prices and other grains prices driving down the cost of, in particular, the Commodity Credit Corporation, which is I think the roughly $30 billion reduction over 10 years that you referred to. If prices do not remain high and instead go, you know, are lower, the cost level would be higher than we project.

Ms. DELAURO. Mm-hmm. But is the impact of the—let me just ask the question on the high price projected on the strong demand for corn-based ethanol, with oil prices going from $75 to $55, any concern that that would drive down the cost for—the demand for corn-based ethanol?

Mr. ORSZAG. I would note that we do in the assumptions assume some sort of walking back from current pricing for a variety of factors, and I would also note we consult in depth with a variety of experts in the agricultural field in order to undertake these projections. So there is a little bit of softening in prices relative to current levels that is embedded in the baseline; and in the outyears, for example, the price per bushel for corn is somewhat lower than it is for 2007.

But I think the underlying structural point that you noted is that we do see significant demand for corn coming from ethanol-related activities, and that is a structural change that is likely to keep prices higher than they would otherwise be in the absence of that source of demand.

Ms. DELAURO. With what, 20 seconds left, what is, again, the historical perspective and what happened in 1996 and what were the results in terms of the Federal farm support cost?

Mr. ORSZAG. Prices were projected to be relatively high at the time of enactment. They turned out to be lower than projected. The, you know, farm prices are highly cyclical. But I would note that, while that did happen and it may happen again, this underlying driver of ethanol-related demand makes it somewhat different than the situation we faced in the mid-1990s.

Ms. DELAURO. Okay. Thank you very much. Thank you, Dr. Orszag. Thank you, Mr. Chairman.

Chairman SPRATT. Another question?

Mr. SCOTT. I did have another question, Mr. Chairman.

Just for the record, we did find out the revenue increases in the 40 years prior to the Bush administration, revenues increased 38 of those 40 years. During the Bush administration, revenues decreased in each of the first 3 years of the administration. The records that we are using only went back to 1938. We were unable to find any time where the revenues actually decreased three consecutive years.

Chairman SPRATT. The gentleman's point is so noted, and the record will show it.

Dr. Orszag, we appreciate very much your being here, your diligence in answering these questions, and we look forward to working with you in particular on the analysis of the President's budget which will be coming on Monday. We need it as soon as we can possibly get it from you, because we are trying to get to the floor by the week after February 15, out of committee by the 15th and on the floor the week after. So that is an ambitious schedule.

Mr. ORSZAG. Did you say February 15?

Chairman SPRATT. Yeah. That is too ambitious. March the 15th.

Mr. ORSZAG. You gave me a little bit of a heart attack, but that is fine.

Chairman SPRATT. But we hope we can have it by the 1st of March, if at all possible.

Mr. ORSZAG. That is our goal.

Chairman SPRATT. Thank you so much and for your superb staff for the excellent work you do for us.

Mr. ORSZAG. Thank you very much, Mr. Chairman.

Chairman SPRATT. Before we adjourn, I would like to ask unanimous consent, Mr. Scott, that all members be allowed to submit an opening statement for the record. Without objection.

Mr. SCOTT. I have no objection, Mr. Chairman.

Chairman SPRATT. I would also ask unanimous consent that members who were not allowed—did not have the opportunity to ask questions be given 7 days to submit questions for the record.

Thank you very much.

[Whereupon, at 12:27 p.m., the committee was adjourned.]