PRELIMINARY ANALYSIS OF PRESIDENT CLINTON'S FISCAL YEAR 2001 BUDGET

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BEFORE THE

COMMITTEE ON THE BUDGET
HOUSE OF REPRESENTATIVES

ONE HUNDRED SIXTH CONGRESS

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CONTENTS

PRELIMINARY ANALYSIS OF PRESIDENT CLINTON'S FISCAL YEAR 2001 BUDGET

WEDNESDAY, FEBRUARY 16, 2000

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

The committee met, pursuant to call, at 10:25 a.m. in room 210, Cannon House Office Building, Hon. John R. Kasich (chairman of the committee) presiding.

Members present: Representatives Kasich, Chambliss, Franks, Smith, Hoekstra, Gutknecht, Sununu, Ryun of Kansas, Wamp, Green, Fletcher, Miller, Ryan of Wisconsin, Toomey, Spratt, Rivers, Thompson, Bentsen, Davis, Markey, Clement, Moran, Hooley, Lucas, and Holt.

Chairman KASICH. 10:25 a.m. The hearing will come to order and—I don't know what that cartoon is—it is not mine. Is that yours?

Mr. CRIPPEN. It is.

Chairman KASICH. It says, I found out about Santa and the tooth fairy, and now I am beginning to wonder about the budget surplus. Frank and Ernest. That is pretty good. It will not take the place, though, of Charles Schulz, as I think everybody will admit. What an absolutely amazing development that on the very last day of the publishing of Charles Schulz's work, that the man passed, and everybody I know thought what a great—how great he was for children and for adults probably more than children.

Dan, we are glad to have you here this morning. I am glad that you are working hard. First of all, I think you have taken your share of criticism, and I think—and I don't—I am not happy about it because I think you are professional, and I know that you had in the United States Senate a very unfortunate meeting over there 6 months ago—I was thinking about it this morning as I was getting ready—where some of the elected officials take delight in pounding on people who are not elected like a punching bag. I didn't like what they did over there, and I think things are settling out a little bit. And when we had your predecessor, we never attempted to ever manipulate or maneuver her any more than we do it with you.

And in our conversations, you have been clear with me, and we don't have that many conversations, but you always make it clear that, John, I have a job to do, and I don't want you to do anything but your job. And I think you are doing great, and I think you are very smart, and I think you have a very good staff, and I am glad that you are upgrading all of your activities there.

I think it is important we go back and look at all the models and try to be as accurate. I think that is what you want to do.

Obviously we are all very, very pleased with the state of the economy. We talked about last week when we had Jack Lew in. In fact, last night I was talking to a friend of mine who lives in the Silicon Valley, and he was saying, I think this boom is going to last at least another 10 years, and I kind of chuckled because this is not a 10-year deal. This is not snow on the ground and then it gets warm and it all melts.

To me we are really in a new period of revolution, idea revolution, just like the industrial revolution, and when you take the development of the high tech, whether it is biotechnology or whether it is the Internet, and you see the various industries now that are starting to grow off of these main industries, that represents really the greatest evidence that we are now in a period of significantly increased productivity, although I have got to tell you I was a little concerned last week when the President made a statement saying that don't anticipate these productivity increases like we have been having them. And I don't like to hear that. That is not designed to be pejorative toward the President. It is just that we better keep these productivity increases up, because if you do not continue to grow at the same rate, and you get stagnant there, then you lose your revenues.

One of my concerns is if the stock market does go negative, and I am not—I believe it is possible that it will go to 20,000 over time, that is my personal view—but if it doesn't grow and we have slumps, people sell less stock, I think we are going to find over time that capital gains collections were a very significant part of the surpluses. Then you could find yourself in a position of not having the surpluses that you want.

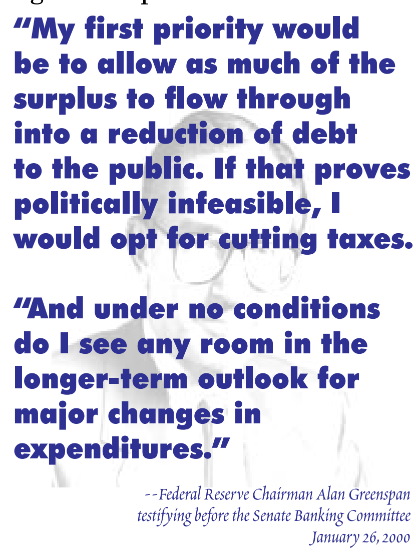
But I am not here to be negative because I can't quite see much on the horizon that should sink this economy in the short and intermediate run, I mean, even including things like oil. I do have concerns, though, about a little bit more of the longer-term impact on the economy. I put education first and foremost. I just really believe that we are educating—failing to educate too many of our young people today, and with people not having the tools—having the brains, but not having the tools, we begin over time to lose that battle of ideas and development. And I just think the education system needs total revamping, and I think that poses a significant threat to the long-term economic growth of our economy.

Secondly, I believe that regulations are a huge part of what government does. Now, we are having a running debate in this country today, and it is a bipartisan debate, everybody talking about what a low percentage of GDP we are spending. I remember in my own district we had a big company out there. They made a lot of money, and, boy, when times were good, they built their infrastructure, and when times went bad, they had to fire people to bring the right people in to chop the infrastructure. With government, once—you know, the reason we are doing so well on GDP right now is because the economy is growing so strong. But if we lock things in place that lead to higher levels of infrastructure for government, then when times are bad, the word around here is, oh, well, we can't make any changes now because the economy is bad. To me, this is the time that you get the reform agenda going again.

In addition to that, I am very concerned about the total inability of Congress to come to grips with the entitlement problems. Now, your report reflects, I think, about 10 years. About 2 or 3 years after that, we fall off a cliff, and I really wish that you had talked about the inability of Congress to address the acute problems of Medicare and—which are devastatingly acute, and the devastating, less acute problems of Social Security and what it can mean to the long-term impact on our economy.

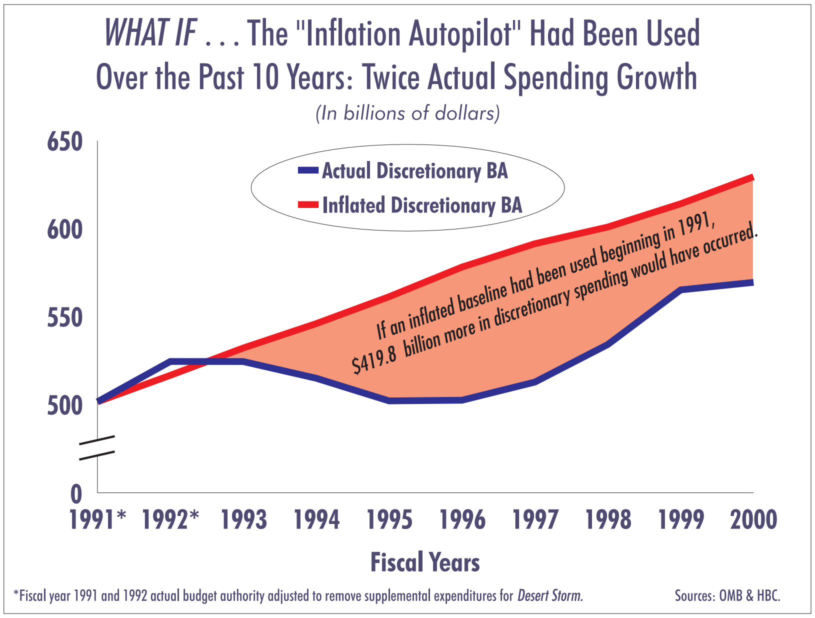
And I think it is also very important we maintain fiscal discipline, the ability to have fiscal discipline. And I can remember back in 1994 visiting with Alan Greenspan and him telling me both privately and then coming and saying publicly that if the Congress can show that they have a commitment to smaller government, then we can have a stronger economy.

I have got just two little deals here I would like to put up. One that I just—I don't know why we didn't see this earlier. It is a quote from Alan Greenspan where the Chairman says in his confirmation hearing, "My first priority would be to allow as much of the surplus to flow through into a reduction of debt to the public. If that proves politically infeasible, I would opt for cutting taxes. And under no conditions do I see any room in the longer-term outlook for major changes in expenditures."



People have always said, well, Greenspan is not for cutting taxes. I don't think that is a correct and proper analysis of where he is, not that I think we ought to be spending all of our time discussing where Alan Greenspan is, but the fact is that he does matter, and that is his position.

Now, if you would stick this other chart up, because we have been talking about the need for inflation increases in discretionary, not even talking about what we are going to do with prescription drugs or any other entitlements programs, particularly the problems of Medicare as it relates to reimbursement. But if you look at that chart, it is a little confusing, but if you go to 1991, the red line represents how much spending we would have had had we just grown at the rate of inflation. The blue line is what we actually did, and as you can see, in 1993 we started to bring spending down fundamentally, the results of cuts in defense.



Then we got down to 1995. Well, look, 1994, 1995, 1996, the glory years, the height of the Republican empire so to speak, you know, the glory days of Greece and Republicans when we were cutting spending and limiting government. You can see what happened to that blue line.

And then it is interesting, isn't it, when you look at 1998, and 1999 and 2000, you know, it is kind of off to the races again because we have surpluses, and when you have surpluses, you spend, because all politicians are fundamentally tarred with the same stick. So what you see there, though, is the gap between that blue line and that inflation-adjusted spending. You have got $419 billion more in spending than you would have had had we restrained discretionary spending, and, frankly, it is twice as much, it is twice as much as where we started in 1991.

So thank goodness we did not go on autopilot and we restrained spending over this decade, and there is credit that goes to both parties on that. There are. Then there is blame that goes to both parties as we kind of escalate our spending again.

I worry that the growth in government brings about more regulations, more bureaucrats, more red tape. And it is interesting. If you talk to people who live in the Silicon Valley, there is a raging debate there as to whether they ought to even engage politicians in Washington. Some of the more—I don't want to say radical—some of the more aggressive ones argue that any time you sit down with a politician, you end up with a compromise that does you in, and they don't come here anymore. They don't want to be here. They don't want to deal with us because they think the result is more regulation and less progress for them.

I just think that we have got lots of good things going. I wish we would be doing more things with entitlement also, and I am going to be talking about that even when I am gone from here. And I hope we don't get carried away with spending and just get loose around here and build a big infrastructure that we can't control. And I hope at some point we are going to actually confront education in this country, and open this system up and reform it, and not have a government monopoly in education in this country, and improve things. So just some observations.

I am glad you are here, Mr. Crippen. I will look forward to Mr. Spratt's comments and then to your testimony.

Mr. SPRATT. Dr. Crippen, welcome. I like your cartoon. I think it honestly sets a good theme for this particular hearing because we have reidentified these projections as if they were ready to be disposed of, and we have yet to earn them. The economy has yet to produce them, as well as the budget.

There are a couple of variables that I think would be useful for you to help us focus on. One the Chairman has just touched upon, and that is what is the right level for discretionary spending. You can't make normative judgments about that, but you can look back over the past and look at the present and tell us what some of the risks are if we understate discretionary spending.

We have focused for the most part in this discussion on discretionary spending. That is the one variable that you manipulate in deriving three different projections. Yesterday the American Federation of Hospitals was in my office, and they were showing me their projection of Medicare over the next several years, emphasizing the fact that in order to attain these surpluses as you projected them, we have got to keep Medicare growing below the cost growth level that was projected in the BBA for several years to come at historically low growth rates, and it is questionable whether or not that can be attained as well.

So there are lots of iffy assumptions underlying these projections. It won't be easy to attain, and they are certainly not automatic assumptions by any means. They will require a lot of discipline on the part of Congress, and cut some things that some of us really aren't advocating right now.

Yesterday we had a meeting of the procurement subcommittee, of the Armed Services Committee, and the Chairman of that subcommittee, Mr. Hunter, who is a Republican and a good friend of mine, said quite earnestly and honestly, we have asked each of the chiefs of staffs of the four services what they need over and above what has been provided in the President's defense budget, which is an increase of $12.2 billion over last year. As I pointed out to him, it is also an increase of $24.4 billion over what we provided for defense in the balanced budget agreement in 1997 for the year 2001. The chiefs told us they need another $15.5 billion for procurement alone. If you add that to the $24.4 billion, you are $40 billion above what was provided for defense in 2001 in the BBA. How can we return to the caps if we are going to make that kind of provision for defense, and then if we don't return to the caps, what is the proper level to send?

I think you have done a good job in laying out the choices for us in the economic projection you have provided us, and I look forward to your testimony to explain those choices and explain the surplus today. Thank you very much for coming.

Chairman KASICH. If I could just—one other comment. I think John raises a very good issue about this whole issue of reimbursement. The question to me on health care is whether we keep pumping money into a model that is clearly not working very well. In our hearings tomorrow, we are going to be talking about Medicare and how hard it is to try to control the spending on it. We clearly have problems in our hospitals, with our physicians. Do we put more in the old model, or do we figure out a way in which we create a new model?

This year I think we will do—John would like to do some hearings on Medicare. I don't know that it will be done before we mark up the budget because we are on a fast track, but whatever we mark up is clearly going to be subject to changes, and it is a really great issue and an important issue because there is real people that pay a price. I just talked to a nurse the other day, pediatric nurse, and she has got seven patients, a number of them, seven patients they need to take care of because the—there is just not enough money there.

These are vexing problems, and it is going to be interesting to see how we deal with it this year and really how we deal with it long term.

Mr. Crippen, you are recognized.

STATEMENT OF DAN L. CRIPPEN, DIRECTOR, CONGRESSIONAL BUDGET OFFICE

Mr. CRIPPEN. Thank you, Mr. Chairman. Before I begin, I want to thank you for your gracious opening comments. I hope that I will ultimately deserve them, but I want to assure you that my colleagues—both those who are here and those who are back across the freeway working—deserve them much more than I do. They are a hard-working, professional crew. I am just representing them here today.

I don't know if any of you ever take time out to look at the comics. Of course, I know a lot of you only read the New York Times, so you don't have a chance. But I do look at the comics, and I brought this one today, as Congressman Spratt said, because I thought it had some relevance to our debate over competing versions of our baseline.

Before I discuss the baseline, however, let me report briefly on our upcoming analysis of the President's budget. Like you, we have had the budget a little more than a week. It will take us another 2 to 3 weeks to finish our analysis and another week or so after that to produce a report. Obviously, if it is the desire of the committee, I will be happy to return next month to discuss that analysis with you. For today, however, I am prepared to speak only about our baseline report. Indeed, we have no analysis yet of the President's budget on which I can report.

But I can report on our assessment of the budget and economic outlook, which has substantially improved since last July. First, we project that there will be an on-budget surplus this year and every year for the next 10 years. During the coming decade, under current policies, we believe the line between Social Security and the rest of the budget will not be crossed. The off-budget Social Security surpluses will accumulate over $2 trillion over the next 10 years (see Chart 1). Thus, if there are no on-budget deficits, debt held by the public will be reduced by at least that amount.

As I will explain in a moment, the on-budget surpluses range from a little more than $800 billion to just under $2 trillion. If those surpluses were dedicated to paying down the national debt, it would be possible to retire all debt held by the public that was available for repurchase in the next 10 years.

Differences in the estimates of the on-budget surplus are attributable to three variations in our baseline, variations based on, as Congressman Spratt said, differing assumptions about the future path of discretionary spending. The first variation assumes strict compliance with CBO's estimates of the spending caps that are in place for 2000. The second variation assumes that discretionary resources are held to the level provided in the 2000 appropriations. The third variation presents the implications of inflating appropriations for 2000 to approximate the resources it would take to continue the same spending over 10 years.

Mr. Chairman, each of these formulations is flawed, and the flaws are more apparent now than ever before. Discretionary spending, as the name implies, is not cast in stone, although we sometimes treat it as such. And a baseline is, among other things, an attempt to extrapolate current policy into the future so that the impact of changes in policy can be measured. But the policy for discretionary appropriations is established one year at a time.

The capped variation, reflecting the agreement reached in 1997 between the Congress and the President, has by our reckoning been breached by ever-increasing amounts in the past 2 years. Adherence to the cap for 2001 would require an absolute reduction in spending of approximately $25 billion.

The freeze variation may provide a good approximation of current discretionary policy from one year to the next, but adherence to it would require unprecedented restraint over the 10 years considered in this outlook.

To assume adjustments for inflation, as our third variation does, makes appropriations appear to be mandatory, not discretionary, implying that the same level of real (inflation-adjusted) resources must be provided each year, regardless of the merits of existing programs and the needs of the future.

CHART 1

CBO BASELINE PROJECTIONS OF THE SURPLUS
(In billions of dollars)

	2000	2001	2001-2005	2001-2010
CAPPED				
On-Budget	23	69	594	1,918
Off-Budget	153	166	978	2,314
Total	176	235	1,571	4,232
FREEZE				
On-Budget	23	22	379	1,858
Off-Budget	153	166	979	2,320
Total	176	188	1,358	4,179
INFLATED				
On-Budget	23	11	148	838
Off-Budget	153	166	978	2,314
Total	176	177	1,126	3,152

1/26/00–Sen.Bud.–Chart 1

Both the freeze and inflated baseline of variations include spending that is not likely to be repeated, although the mechanics of constructing those variations inherently assume that it will be. For example, funds for the 2000 census as well as all other funds appropriated for emergency purposes, including one-time items such as funding for the Wye River Accords, are assumed to be repeated in 2001, 2002, and every year thereafter.

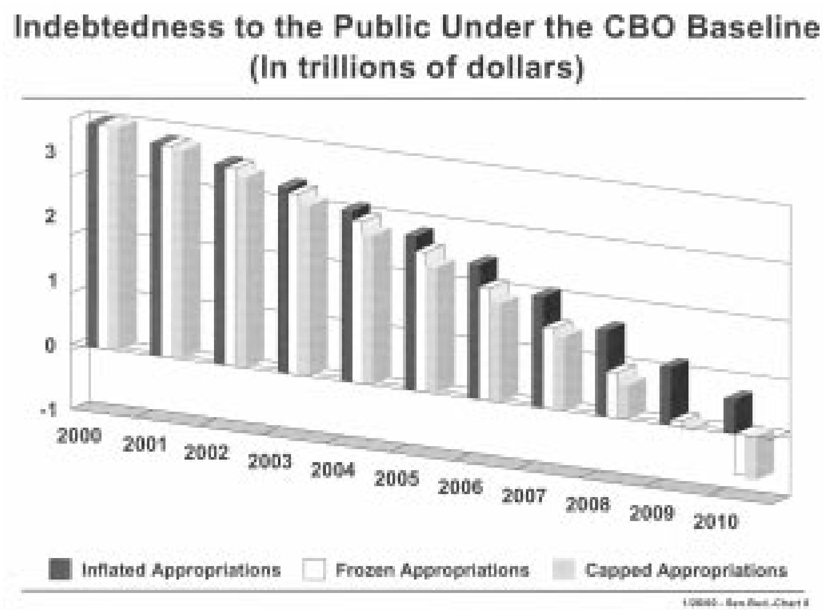
In addition, the inflated variation implicitly assumes no increases in government productivity and no improvements in providing government services, despite the obvious improvements in private-sector productivity that have been reported.

The second chart shows that total surpluses would exceed total debt held by the public in 2009 or 2010, under both the capped and freeze alternatives (see Chart 2). With the inflated alternative, total surpluses would exceed total debt soon after the end of the decade.

A word of caution here. The tables in the testimony show debt held by the public to be positive in those last years. That is because even though sufficient surpluses would be generated to retire all debt, there is an irreducible minimum debt over this 10-year period because of outstanding long-term bonds and, we assume, the continuation of the savings bond program. To determine the Nation's true net debtor position, the amounts in the "excess cash" line must be subtracted from debt held by the public. For our purposes, we assume that the excess cash generated under this outlook would be invested in a way that produced a return equal to that on short-term, risk-free instruments.

To summarize, if these projections are in the ballpark and the underlying mandatory policies are not changed, the Federal Government should be able to save an amount roughly equal to or greater than the amount of debt held by the public over the next decade.

CHART 2



Our next chart summarizes what has changed since July (see Chart 3). We compare the capped alternative with the July baseline because the July estimates also assumed adherence to the cap, allowing us to make strict comparisons between the two.

CHART 3

CHANGES IN CBO PROJECTIONS OF THE TOTAL SURPLUS SINCE JULY UNDER THE CAPPED BASELINE

	2000	2001	2009	2000-2009
July Surplus	161	193	413	2,895
Changes				
Legislative	-30	-17	-10	-127
Economic	25	40	101	640
Technical	20	19	74	366
Total Changes	15	42	166	879
January Surplus	176	235	579	3,774

1/26/00–Sen.Bud.–Chart 2

Regarding legislative changes since July, spending increases and revenue reductions obviously reduce the surpluses, but the effects of economic and technical changes in our forecast are eight times greater than the effects of legislation. The economy, specifically productivity, continues to grow at a rate well above previous trends. We now assume that growth in real gross domestic product (GDP) will average 0.4 percentage points more than we assumed in July. Half of that increase is due to productivity.

In the 20 years prior to 1996, productivity grew at an average rate of 1.6 percent. In the past 4 years, productivity has grown at an average rate of 2.6 percent, a full percentage point higher. We assume that about 60 percent of that increase will prove to be permanent, for an average productivity growth of 2.2 percent over the 2001–2010 period.

Tax revenues remain higher relative to GDP than past experience would suggest. Over time, we assume that collections will decline relative to GDP and for some, categories will revert to past patterns, with personal income taxes remaining somewhat higher than historical levels and corporate taxes slightly lower.

Finally, the slowdown in Medicare spending—last year's spending actually declined by close to 1 percent—has lowered the base. Some of the dampening effect of reforms under the Balanced Budget Act of 1997 (BBA) and enhanced enforcement of antifraud measures will continue to restrain Medicare growth in the future—to the tune of about $140 billion less in costs over the 10 years than we had earlier estimated.

Thus, the story continues to be one of strong economic performance and growth in revenues that is greater than previously forecast, coupled with a small reduction in expected spending for Medicare.

As with any 10-year forecast, there is a great deal of uncertainty to any particular path. We generate specific numbers, but no one should be sanguine about the apparent precision they imply. Many of the numbers presented here are the result of accumulating many estimates, which are themselves uncertain. This year, the uncertainty is probably greater than usual, encompassing uncertainty about the long-run trend in productivity and future spending and tax policies.

Indeed, most other economic forecasters do not venture to project as far forward as 10 years. The next chart compares our economic forecasts for this year, next year, and the next 5 years (see Chart 4). Looking at the 5-year averages in the far right-hand column, you can see that we are at the bottom of the range of forecasts, and we are obviously quite close to our brethren at the Office of Management and Budget (OMB).

We don't pretend to know much, Mr. Chairman, about economic performance in the last half of our forecast other than that we know growth in the economy will be limited to the increase in the workforce and in productivity, a combination that we assume for the terms of this projection will amount to growth of 2.9 percent in a steady state toward the end of the decade.

It is once again obvious that small changes over a long period make a big difference, a lesson I hope we can carry over to the reform of programs for the too-soon-to-be-elderly people like me. The apparent good news in this forecast is tempered by what lies just over the 10-year horizon—namely, my generation, the baby boomers.

CHART 4

ECONOMIC ASSUMPTIONS
(Growth rates, year over year)

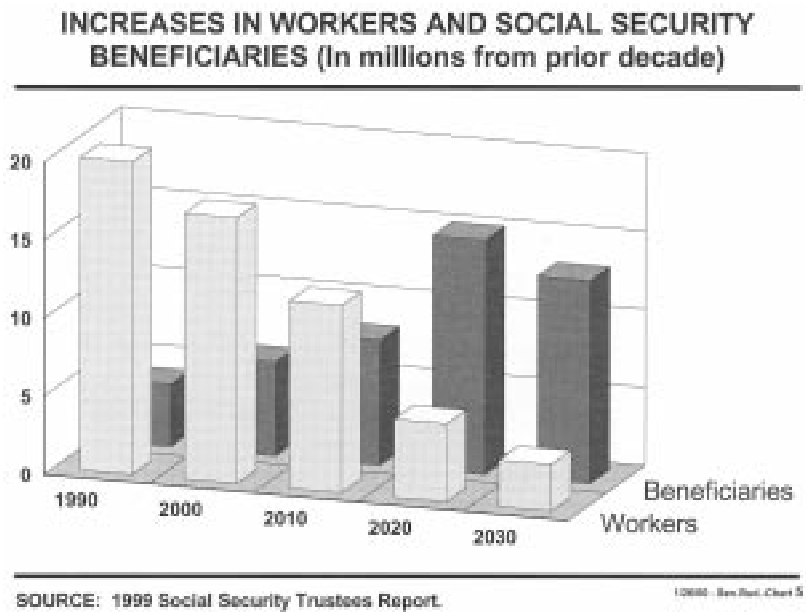
	2000	2001	2001-2005
Real GDP			
DRI	3.6	2.9	3.2
MA	3.8	2.8	2.8
WEFA	3.6	3.7	3.4
OMB	3.3	2.7	2.7
CBO	3.3	3.1	2.7
Nominal GDP			
DRI	5.1	4.6	5.3
MA	5.6	5.0	5.4
WEFA	5.3	5.2	4.8
OMB	4.9	4.9	4.8
CBO	5.0	4.8	4.4
CPI-U			
DRI	2.4	2.2	2.6
MA	2.5	2.6	3.2
WEFA	2.6	2.4	2.4
OMB	2.6	2.4	2.6
CBO	2.5	2.4	2.5

2/16/00-Hse.Bud.-Chart 4

Between this year and 2030, the number of retirees will grow by 80 percent, although the number of workers will increase by only

10 percent. The portion of the economy that will be transferred from the younger working population—that is, from our children—to us will almost double, rising from just over 7 percent to just under 14 percent of GDP. To try and put that in perspective, Mr. Chairman, if the characteristics of 2030——

CHART 5



Chairman KASICH. Give us those numbers a little slower. Those are—that is not in your testimony here, is it?

Mr. CRIPPEN. Probably not. From this year to 2030, the number of retirees will grow by approximately 80 percent, yet the number of workers will only grow by about 10 percent (see Chart 5).

From our estimates, we assume that the portion of the economy that will be dedicated to support retirees will grow from 7 percent of GDP to 14 percent of GDP. I'll try and put that in perspective in relation to today's terms and today's debates. If the characteristics of 2030 applied to the budget you are working on for 2001—that is to say, if Social Security, Medicare, and Medicaid consumed an amount equal to 14 percent of GDP—you would have about $400 billion to spend on everything else next year instead of the roughly $1 trillion you will have to fund the rest of the government. Put another way, you would have to raise taxes by $600 billion for next year alone in order to have the same relative spending for everything other than the programs for the elderly.

As the economic outlook improves, even in the short run, so does the outlook, of course, for those programs. I would like to note that the 14 percent of GDP we project for programs for the elderly in 2030 is down over 1 full percentage point from last July, primarily because increased economic growth, albeit small, makes a big difference over the long haul.

Think of it this way. The calculation of the share of GDP is a fraction with two moving parts (see Chart 6). The relative amount of resources transferred from the productive working population to retirees can be diminished by reducing the obligations or benefits—the numerator of the fraction—or by growing the economy—the fraction's denominator.

CHART 6

$$\frac{\text{OBLIGATIONS TO ELDERLY}}{\text{GDP}}$$

Can we grow our way out of this problem? Probably not, and certainly not if we define the problem as keeping the relative share of the economy transferred to the elderly constant. What is likely is that my generation when retired will consume more than 7 percent of GDP because the economy will not grow that quickly. Nevertheless, the larger the economy, the easier it will certainly be to support those retirees.

Again, in terms of the budget you are about to write, the 1 percent improvement in the 2030 forecast translates into roughly $100 billion today. That is, the higher growth in this forecast is the equivalent of $100 billion in spending cuts or tax increases that would otherwise be necessary to fund government as we know it.

Ultimately, Mr. Chairman, it is not the size of the balances in a trust fund that will limit our ability to pay for these long-term obligations but the size of the economy. How much of the funding are we going to push off to succeeding generations? How much of what our children produce are we going to demand that they give us? Thank you, Mr. Chairman.

[The prepared statement of Dr. Crippen follows:]

PREPARED STATEMENT OF DAN L. CRIPPEN, DIRECTOR, CONGRESSIONAL BUDGET OFFICE

Mr. Chairman, Congressman Spratt, and Members of the Committee, I am pleased to be with you this morning to discuss the budget and economic outlook for fiscal years 2001 to 2010.

Total Federal revenues exceeded spending by $124 billion in fiscal year 1999, producing a surplus in the total budget for the second consecutive year. The Congressional Budget Office (CBO) estimates that without legislative changes, that surplus will rise to $176 billion in 2000 (see Summary Table 1). If current policies remain in place, the surplus will continue to increase after 2000, CBO projects; however, the size of that increase depends on the amount of discretionary spending that is assumed.

SUMMARY TABLE 1.—THE BUDGET OUTLOOK UNDER CURRENT POLICIES

[By fiscal year, in billions of dollars]

	Actual 1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	Total 2001–2010
Discretionary Spending Grows at the Rate of Inflation After 2000:													
On-Budget Surplus	1	23	11	26	31	37	43	86	115	131	162	195	838
Off-Budget Surplus	124	153	166	182	195	209	225	239	254	268	281	295	2,314
Total Surplus	124	176	177	209	227	246	268	325	368	399	444	489	3,152
Discretionary Spending Is Frozen at the Level Enacted for 2000:													
On-Budget Surplus	1	23	22	50	76	102	129	194	245	288	346	407	1,858
Off-Budget Surplus	124	153	166	182	196	209	226	240	255	269	282	296	2,320
Total Surplus	124	176	188	232	271	312	355	434	500	556	628	703	4,179
Discretionary Spending Equals CBO's Estimates of the Caps Through 2002 and Grows at the Rate of Inflation Thereafter:													
On-Budget Surplus	1	23	69	112	126	136	151	199	231	258	298	339	1,918
Off-Budget Surplus	124	153	166	182	195	209	225	239	254	268	281	295	2,314
Total Surplus	124	176	235	294	321	345	376	438	485	526	579	633	4,232

SOURCE: Congressional Budget Office.

CBO's baseline projections are intended to provide the Congress with estimates of the spending and revenues that will occur if current laws affecting the budget remain unchanged. In the case of mandatory spending and revenues, which are generally governed by permanent laws, the projections incorporate the effects of anticipated changes in the economy, demographics, and other relevant factors.

In the case of discretionary spending, however, which is controlled by annual appropriation acts, no consensus exists about how to define current policy as it applies to future years. Is it best represented by the statutory caps on discretionary budget authority and outlays, which were most recently specified in the Balanced Budget Act of 1997? Or does section 257(c)(1) of the Balanced Budget and Emergency Deficit Control Act of 1985 better depict current policy by specifying that baselines should be adjusted for inflation? Or is current policy for discretionary spending simply the amount that was provided in appropriations for the current year?

Without any definitive answer to those questions, CBO presents three variants of its baseline in this report. Each one reflects a different assumption about discretionary spending.

- The "inflated" variation assumes that budget authority for discretionary programs grows at the rate of inflation each year after 2000.
- The "freeze" variation pegs discretionary budget authority to the level enacted for the current year, plus amounts already enacted for 2001.
- The "capped" variation assumes that discretionary spending equals CBO's estimates of the statutory caps through 2002 and grows at the rate of inflation thereafter.

The Congress has used each of those spending paths as a benchmark in some past budget deliberations. Each alternative has limitations, however. As they currently stand, the caps may not be a realistic reference point given recent action on discretionary spending. The inflated baseline, for its part, implicitly earmarks future resources to maintain the real (inflation-adjusted) level of discretionary spending even though there is no explicit statutory basis for such earmarking. And the freeze baseline ignores the effects of pay raises and inflation—costs that could erode the amount of services or programs that the government can deliver. In addition, both the inflated and freeze baselines mechanically repeat funding for programs (such as the decennial census) whose needs are known to be significantly greater or less in future years.

Most of the components of CBO's baseline budget projections—revenues, mandatory spending, and offsetting receipts—are the same no matter which assumption about discretionary spending is used. Net interest costs, however, depend on the amount of projected debt outstanding, which in turn reflects the choice of paths for discretionary outlays. Likewise, projections of the surplus will vary depending on assumptions about the discretionary portion of the budget and the resulting effects on interest costs.

Regardless of the variant, the budgetary picture is a bright one. Between 2001 and 2010, accumulated surpluses are projected to total $3.2 trillion under the inflated baseline and $4.2 trillion under the freeze or capped baseline. On-budget surpluses (which exclude the spending and revenues of Social Security and the Postal Service) total more than $800 billion under the inflated baseline and $1.9 trillion under the other two baselines.

Those surpluses are much larger than the ones that CBO projected last July in "The Economic and Budget Outlook: An Update." Comparing capped baselines (which CBO used in that report), the cumulative surplus for the 2000–2009 period is now $879 billion higher, despite legislation enacted since July that reduces that surplus by a total of $127 billion between 2000 and 2009. The effects of new legislation are more than offset by changes in economic and other factors that increase revenues by $651 billion over that period and reduce spending by $355 billion.

Most of the improvement in the budgetary picture results from CBO's updated economic outlook. Real economic growth is forecast to average about 3 percent a year over the next 2 years, with only a slight rise in the underlying rate of inflation. For the longer term, CBO projects that real growth will average 2.7 percent a year from 2002 through 2010, taking into account the possibility of booms and recessions during that period.

THE BUDGET OUTLOOK

The total budget surplus of $176 billion that CBO is projecting for this year results from a $153 billion surplus in off-budget accounts—mainly the Social Security trust funds, whose inflows and outflows are accounted for separately from those of the rest of the government—and a $23 billion surplus in on-budget accounts. That on-budget surplus would be the largest ever in nominal dollars. Measured as a percentage of gross domestic product (GDP), it would be the largest since 1951.

Assuming that current policies do not change, CBO projects growing surpluses over the next decade. The total budget surplus would reach between 3 percent and 5 percent of GDP by 2010 depending on the path of discretionary spending (see Summary Tables 2, 3, and 4). The on-budget surplus would range between 1 percent and 3 percent of GDP.

SUMMARY TABLE 2.—CBO BASELINE BUDGET PROJECTIONS, ASSUMING THAT DISCRETIONARY SPENDING GROWS AT THE RATE OF INFLATION AFTER 2000

[By fiscal year]

	Actual 1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010
IN BILLIONS OF DOLLARS												
Revenues:												
Individual income	879	945	986	1,026	1,068	1,112	1,162	1,217	1,275	1,339	1,407	1,480
Corporate income	185	189	189	187	190	194	200	208	216	225	233	242
Social insurance	612	653	684	714	742	770	808	842	878	913	954	998
Other	151	158	158	169	177	187	192	198	202	210	218	226
Total	1,827	1,945	2,016	2,096	2,177	2,263	2,361	2,465	2,572	2,686	2,813	2,946
On-budget	1,383	1,465	1,515	1,571	1,630	1,693	1,764	1,843	1,923	2,010	2,106	2,208
Off-budget	444	480	502	525	547	570	597	623	649	676	707	738
Outlays:												
Discretionary spending	575	603	635	650	669	684	702	716	730	750	768	786
Mandatory spending	977	1,020	1,071	1,119	1,182	1,249	1,329	1,385	1,460	1,550	1,643	1,744
Offsetting receipts	−78	−79	−85	−91	−94	−93	−98	−103	−108	−113	−119	−125
Net interest	230	224	218	209	194	177	160	142	122	101	80	68
Proceeds from investing excess cash	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	−3	−16
Total	1,703	1,769	1,839	1,888	1,950	2,017	2,093	2,140	2,204	2,287	2,369	2,457
On-budget	1,382	1,442	1,504	1,545	1,598	1,656	1,721	1,756	1,808	1,879	1,944	2,014
Off-budget	321	327	336	343	352	361	372	384	396	409	425	443
Surplus	124	176	177	209	227	246	268	325	368	399	444	489
On-budget	1	23	11	26	31	37	43	86	115	131	162	195
Off-budget	124	153	166	182	195	209	225	239	254	268	281	295
Debt Held by the Public	3,633	3,455	3,292	3,097	2,884	2,651	2,394	2,080	1,721	1,330	1,016	941
AS A PERCENTAGE OF GDP												
Revenues:												
Individual income	9.6	9.9	9.8	9.8	9.7	9.7	9.7	9.8	9.8	9.9	9.9	10.0
Corporate income	2.0	2.0	1.9	1.8	1.7	1.7	1.7	1.7	1.7	1.7	1.6	1.6
Social insurance	6.7	6.8	6.8	6.8	6.8	6.7	6.8	6.8	6.8	6.7	6.7	6.7
Other	1.7	1.6	1.6	1.6	1.6	1.6	1.6	1.6	1.6	1.5	1.5	1.5
Total	20.0	20.3	20.1	20.0	19.9	19.8	19.8	19.8	19.8	19.8	19.8	19.8
On-budget	15.2	15.3	15.1	15.0	14.9	14.8	14.8	14.8	14.8	14.8	14.8	14.9
Off-budget	4.9	5.0	5.0	5.0	5.0	5.0	5.0	5.0	5.0	5.0	5.0	5.0

SUMMARY TABLE 2.—CBO BASELINE BUDGET PROJECTIONS, ASSUMING THAT DISCRETIONARY SPENDING GROWS AT THE RATE OF INFLATION AFTER 2000—Continued

[By fiscal year]

	Actual 1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010
Outlays:												
Discretionary spending	6.3	6.3	6.3	6.2	6.1	6.0	5.9	5.7	5.6	5.5	5.4	5.3
Mandatory spending	10.7	10.6	10.7	10.7	10.8	10.9	11.1	11.1	11.2	11.4	11.6	11.7
Offsetting receipts	−0.9	−0.8	−0.8	−0.9	−0.9	−0.8	−0.8	−0.8	−0.8	−0.8	−0.8	−0.8
Net interest	2.5	2.3	2.2	2.0	1.8	1.6	1.3	1.1	0.9	0.7	0.6	0.5
Proceeds from investing excess cash	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	*	−0.1
Total	18.7	18.5	18.3	18.0	17.8	17.7	17.6	17.2	16.9	16.8	16.7	16.5
On-budget	15.2	15.1	15.0	14.7	14.6	14.5	14.4	14.1	13.9	13.8	13.7	13.6
Off-budget	3.5	3.4	3.3	3.3	3.2	3.2	3.1	3.1	3.0	3.0	3.0	3.0
Surplus	1.4	1.8	1.8	2.0	2.1	2.2	2.2	2.6	2.8	2.9	3.1	3.3
On-budget	*	0.2	0.1	0.3	0.3	0.3	0.4	0.7	0.9	1.0	1.1	1.3
Off-budget	1.4	1.6	1.7	1.7	1.8	1.8	1.9	1.9	2.0	2.0	2.0	2.0
Debt Held by the Public	39.9	36.1	32.8	29.5	26.3	23.2	20.1	16.7	13.2	9.8	7.2	6.3

SOURCE: Congressional Budget Office.
NOTE: n.a. = not applicable; * = less than 0.05 percent of GDP.

SUMMARY TABLE 3.—CBO BASELINE BUDGET PROJECTIONS, ASSUMING THAT DISCRETIONARY SPENDING IS FROZEN AT THE LEVEL ENACTED FOR 2000

[By fiscal year]

	Actual 1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010
	IN BILLIONS OF DOLLARS											
Revenues:												
Individual income	879	945	986	1,026	1,068	1,112	1,162	1,217	1,275	1,339	1,407	1,480
Corporate income	185	189	189	187	190	194	200	208	216	225	233	242
Social insurance	612	653	684	714	742	770	808	842	878	913	954	998
Other	151	158	158	169	177	187	192	198	202	210	218	226
Total	1,827	1,945	2,016	2,096	2,177	2,263	2,361	2,465	2,572	2,686	2,813	2,946
On-budget	1,383	1,465	1,515	1,571	1,630	1,693	1,764	1,843	1,923	2,010	2,106	2,208
Off-budget	444	480	502	525	547	570	597	623	649	676	707	738
Outlays:												
Discretionary spending	575	603	624	628	627	624	625	623	620	622	621	621

Mandatory spending	977	1,020	1,071	1,119	1,182	1,249	1,329	1,385	1,460	1,550	1,643	1,744
Offsetting receipts	−78	−79	−85	−91	−94	−93	−98	−103	−108	−113	−119	−125
Net interest	230	224	218	208	191	171	150	127	101	81	72	68
Proceeds from investing excess cash	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	−9	−33	−65
Total	1,703	1,769	1,829	1,864	1,905	1,951	2,006	2,032	2,073	2,130	2,185	2,244
On-budget	1,382	1,442	1,493	1,521	1,554	1,590	1,635	1,649	1,678	1,722	1,761	1,801
Off-budget	321	327	336	342	352	361	372	383	395	408	424	442
Surplus	124	176	188	232	271	312	355	434	500	556	628	703
On-budget	1	23	22	50	76	102	129	194	245	288	346	407
Off-budget	124	153	166	182	196	209	226	240	255	269	282	296
Debt Held by the Public	3,633	3,455	3,281	3,062	2,805	2,506	2,162	1,739	1,249	1,078	1,016	941
AS A PERCENTAGE OF GDP												
Revenues:												
Individual income	9.6	9.9	9.8	9.8	9.7	9.7	9.7	9.8	9.8	9.9	9.9	10.0
Corporate income	2.0	2.0	1.9	1.8	1.7	1.7	1.7	1.7	1.7	1.7	1.6	1.6
Social insurance	6.7	6.8	6.8	6.8	6.8	6.7	6.8	6.8	6.8	6.7	6.7	6.7
Other	1.7	1.6	1.6	1.6	1.6	1.6	1.6	1.6	1.6	1.5	1.5	1.5
Total	20.0	20.3	20.1	20.0	19.9	19.8	19.8	19.8	19.8	19.8	19.8	19.8
On-budget	15.2	15.3	15.1	15.0	14.9	14.8	14.8	14.8	14.8	14.8	14.8	14.9
Off-budget	4.9	5.0	5.0	5.0	5.0	5.0	5.0	5.0	5.0	5.0	5.0	5.0
Outlays:												
Discretionary spending	6.3	6.3	6.2	6.0	5.7	5.5	5.2	5.0	4.8	4.6	4.4	4.2
Mandatory spending	10.7	10.6	10.7	10.7	10.8	10.9	11.1	11.1	11.2	11.4	11.6	11.7
Offsetting receipts	−0.9	−0.8	−0.8	−0.9	−0.9	−0.8	−0.8	−0.8	−0.8	−0.8	−0.8	−0.8
Net interest	2.5	2.3	2.2	2.0	1.7	1.5	1.3	1.0	0.8	0.6	0.5	0.5
Proceeds from investing excess cash	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	−0.1	−0.2	−0.4
Total	18.7	18.5	18.2	17.8	17.4	17.1	16.8	16.3	15.9	15.7	15.4	15.1
On-budget	15.2	15.1	14.9	14.5	14.2	13.9	13.7	13.2	12.9	12.7	12.4	12.1
Off-budget	3.5	3.4	3.3	3.3	3.2	3.2	3.1	3.1	3.0	3.0	3.0	3.0
Surplus	1.4	1.8	1.9	2.2	2.5	2.7	3.0	3.5	3.8	4.1	4.4	4.7
On-budget	*	0.2	0.2	0.5	0.7	0.9	1.1	1.6	1.9	2.1	2.4	2.7
Off-budget	1.4	1.6	1.7	1.7	1.8	1.8	1.9	1.9	2.0	2.0	2.0	2.0
Debt Held by the Public	39.9	36.1	32.7	29.2	25.6	21.9	18.1	14.0	9.6	7.9	7.2	6.3

SOURCE: Congressional Budget Office.
NOTE: n.a. = not applicable; * = less than 0.05 percent of GDP.

SUMMARY TABLE 4.—CBO BASELINE BUDGET PROJECTIONS, ASSUMING THAT DISCRETIONARY SPENDING EQUALS CBO'S ESTIMATES OF THE STATUTORY CAPS THROUGH 2002 AND GROWS AT THE RATE OF INFLATION THEREAFTER

[By fiscal year]

	Actual 1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010
IN BILLIONS OF DOLLARS												
Revenues:												
Individual income	879	945	986	1,026	1,068	1,112	1,162	1,217	1,275	1,339	1,407	1,480
Corporate income	185	189	189	187	190	194	200	208	216	225	233	242
Social insurance	612	653	684	714	742	770	808	842	878	913	954	998
Other	151	158	158	169	177	187	192	198	202	210	218	226
Total	1,827	1,945	2,016	2,096	2,177	2,263	2,361	2,465	2,572	2,686	2,813	2,946
On-budget	1,383	1,465	1,515	1,571	1,630	1,693	1,764	1,843	1,923	2,010	2,106	2,208
Off-budget	444	480	502	525	547	570	597	623	649	676	707	738
Outlays:												
Discretionary spending	575	603	578	571	585	600	615	630	646	662	679	696
Mandatory spending	977	1,020	1,071	1,119	1,182	1,249	1,329	1,385	1,460	1,550	1,643	1,744
Offsetting receipts	−78	−79	−85	−91	−94	−93	−98	−103	−108	−113	−119	−125
Net interest	230	224	217	204	183	162	139	115	92	77	72	68
Proceeds from investing excess cash	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	−2	−16	−41	−70
Total	1,703	1,769	1,781	1,802	1,856	1,918	1,985	2,027	2,087	2,161	2,234	2,313
On-budget	1,382	1,442	1,446	1,460	1,504	1,557	1,613	1,644	1,692	1,752	1,809	1,870
Off-budget	321	327	336	343	352	361	372	384	396	409	425	443
Surplus	124	176	235	294	321	345	376	438	485	526	579	633
On-budget	1	23	69	112	126	136	151	199	231	258	298	339
Off-budget	124	153	166	182	195	209	225	239	254	268	281	295
Debt Held by the Public	3,633	3,455	3,234	2,954	2,647	2,314	1,949	1,522	1,142	1,078	1,016	941
AS A PERCENTAGE OF GDP												
Revenues:												
Individual income	9.6	9.9	9.8	9.8	9.7	9.7	9.7	9.8	9.8	9.9	9.9	10.0
Corporate income	2.0	2.0	1.9	1.8	1.7	1.7	1.7	1.7	1.7	1.7	1.6	1.6
Social insurance	6.7	6.8	6.8	6.8	6.8	6.7	6.8	6.8	6.8	6.7	6.7	6.7
Other	1.7	1.6	1.6	1.6	1.6	1.6	1.6	1.6	1.6	1.5	1.5	1.5
Total	20.0	20.3	20.1	20.0	19.9	19.8	19.8	19.8	19.8	19.8	19.8	19.8
On-budget	15.2	15.3	15.1	15.0	14.9	14.8	14.8	14.8	14.8	14.8	14.8	14.9

Off-budget	4.9	5.0	5.0	5.0	5.0	5.0	5.0	5.0	5.0	5.0	5.0	5.0
Outlays:												
Discretionary spending	6.3	6.3	5.8	5.4	5.3	5.3	5.2	5.1	5.0	4.9	4.8	4.7
Mandatory spending	10.7	10.6	10.7	10.7	10.8	10.9	11.1	11.1	11.2	11.4	11.6	11.7
Offsetting receipts	−0.9	−0.8	−0.8	−0.9	−0.9	−0.8	−0.8	−0.8	−0.8	−0.8	−0.8	−0.8
Net interest	2.5	2.3	2.2	1.9	1.7	1.4	1.2	0.9	0.7	0.6	0.5	0.5
Proceeds from investing excess cash	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	*	−0.1	−0.3	−0.5
Total	18.7	18.5	17.7	17.2	16.9	16.8	16.6	16.3	16.0	15.9	15.7	15.6
On-budget	15.2	15.1	14.4	13.9	13.7	13.6	13.5	13.2	13.0	12.9	12.7	12.6
Off-budget	3.5	3.4	3.3	3.3	3.2	3.2	3.1	3.1	3.0	3.0	3.0	3.0
Surplus	1.4	1.8	2.3	2.8	2.9	3.0	3.2	3.5	3.7	3.9	4.1	4.3
On-budget	*	0.2	0.7	1.1	1.1	1.2	1.3	1.6	1.8	1.9	2.1	2.3
Off-budget	1.4	1.6	1.7	1.7	1.8	1.8	1.9	1.9	2.0	2.0	2.0	2.0
Debt Held by the Public	39.9	36.1	32.2	28.1	24.2	20.3	16.3	12.2	8.8	7.9	7.2	6.3

SOURCE: Congressional Budget Office.
NOTE: n.a. = not applicable; * = less than 0.05 percent of GDP.

CHANGES SINCE JULY

CBO's current budget outlook is considerably more positive than the one described in its July 1999 report. Since then, CBO estimates, the Congress and the President have enacted legislation that increases projected spending over the 2000–2009 period by about $109 billion and reduces projected revenues by $18 billion, compared with the levels in CBO's July baseline (see Summary Table 5). The majority of that legislative action occurred at the end of the session, when the Congress and the President enacted the District of Columbia appropriation act and nine other acts enacted by reference—four regular appropriation acts (for the Departments of Commerce, Justice, and State; for foreign operations; for the Department of the Interior; and for the Departments of Labor, Health and Human Services, and Education), a miscellaneous appropriation act, and four additional acts. The effects of that legislation, however, have been more than offset by changes in CBO's estimates of future revenues and outlays that have added to projected surpluses.

SUMMARY TABLE 5.—CHANGES IN CBO PROJECTIONS OF THE SURPLUS SINCE JULY 1999, UNDER THE CAPPED BASELINE

[By fiscal year, in billions of dollars]

	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	Total 2000–2009
July Baseline Total Surplus [1]	161	193	246	247	266	286	334	364	385	413	n.a.
Changes:											
Legislative:											
Revenues	3	−6	−8	−2	−2	−1	−1	*	*	*	−18
Outlays [2]	−33	−11	−9	−8	−7	−7	−8	−8	−9	−9	−109
Subtotal	−30	−17	−18	−10	−9	−8	−8	−9	−9	−10	−127
Economic:											
Revenues	23	41	52	54	53	53	54	56	60	65	510
Outlays [2]	2	−1	−3	1	8	13	19	24	30	36	130
Subtotal	25	40	49	55	61	66	74	80	89	101	640
Technical:											
Revenues	14	12	8	9	13	14	15	16	18	22	141
Outlays [2]	6	7	8	20	14	19	23	34	43	51	225
Subtotal	20	19	16	28	27	33	38	50	61	74	366
Total Changes	15	42	47	73	79	90	104	121	141	166	879
January Baseline Total Surplus	176	235	294	321	345	376	438	485	526	579	n.a.
Memorandum:											
Total Change in Revenues	40	46	51	60	64	66	69	71	77	88	634
Total Change in Outlays [2]	−25	−4	−4	13	15	24	35	50	64	78	245

SOURCE: Congressional Budget Office.

NOTE: n.a. = not applicable; * = less than $500 million.

[1] Assumes that discretionary spending equals CBO's estimates of the statutory caps through 2002 and grows at the rate of inflation thereafter.

[2] Increases in outlays are shown with a negative sign because they reduce surpluses.

Most of the improvement in the budget outlook since July results from the continuing strength of the economy, which CBO estimates will produce higher revenues. The current revenue projections are more than $500 billion higher over the 10-year period because of changes in CBO's economic forecast. Most of that increase stems from higher projected levels of wage and salary income, which boost receipts from individual income and social insurance taxes.

CBO projects that interest rates will be approximately 1 percentage point higher in 2001 and 2002 than previously forecast and at least 0.3 percentage points higher after that. Such changes boost anticipated interest costs (in the capped baseline) by $56 billion through 2009. At the same time, higher revenue projections and other factors lower the projected costs of servicing the Federal debt by as much as $31 billion a year by 2009 and by a total of $138 billion over the 10-year period.

Changes in factors other than legislation and the economic outlook (so-called technical changes) increase the surplus under the capped baseline by $366 billion over 10 years. Technical changes to revenue projections account for $141 billion of that difference—mostly the result of an increase in projected realizations of capital gains in the near term and other effects on social insurance taxes and individual income taxes in later years. Technical changes to outlay projections (other than for debt service) represent a similar amount—nearly all of it resulting from changes to CBO's estimates of Medicare spending. Continued emphasis on improving compliance with program rules and a larger-than-anticipated drop in the use of home health care services have slowed the growth of Medicare spending, prompting CBO to adjust its estimates downward.

REVENUE PROJECTIONS FOR 2000 THROUGH 2010

CBO estimates that total Federal revenues will exceed $1.9 trillion in fiscal year 2000 if current policies remain unchanged—marking the eighth consecutive year in which the growth of revenues has outstripped the growth of gross domestic product. Revenues are expected to grow more slowly than GDP through 2004 and then at about the same rate as GDP through 2010. In that year, revenues are projected to be $2.9 trillion, or about 19.8 percent of GDP.

Although revenues will continue to grow, CBO expects the rate of growth to slow from the rapid pace of the past few years. From 1994 to 1998, revenues rose at an average rate of 8.3 percent a year, much faster than GDP. Consequently, revenues as a percentage of GDP increased from 18.1 percent in 1994 to 19.9 percent in 1998. Although revenue growth slowed to 6.1 percent in 1999, it still exceeded GDP growth and boosted the ratio of receipts to GDP to a postwar high of 20 percent.

In CBO's forecast, receipts will increase slightly faster this year (6.4 percent) than in 1999. They will also grow faster than GDP, pushing the ratio of revenues to GDP to 20.3 percent, which is expected to become the postwar peak. Beginning next year, however, CBO expects receipts to grow by roughly 4 percent a year through 2004. That rate is projected to rise to about 4.5 percent a year between 2005 and 2010. Although GDP will grow faster than receipts during that period, on average, the ratio of receipts to GDP will stay close to its peak, remaining at 19.8 percent.

Individual income tax receipts—bolstered primarily by higher realizations of capital gains, growth in real incomes, and especially rapid growth in income among high-income taxpayers—fueled the rapid rise in revenues of the past few years. Those receipts are also an important contributor to the slower growth of revenues projected for the next few years. Higher realizations of capital gains stemmed largely from the sharp rise in stock prices. Effective tax rates rose because an increasing number of taxpayers fell into the high-income category and were therefore taxed at higher marginal rates. Furthermore, those taxpayers experienced higher-than-average growth in income. None of those sources of rapid growth in revenues are expected to persist indefinitely. As they play smaller roles in boosting receipts, revenue growth is projected to slow.

OUTLAY PROJECTIONS FOR 2000 THROUGH 2010

CBO expects Federal spending to total $1.8 trillion in fiscal year 2000. Under current policies, that figure is projected to rise to between $2.2 trillion and $2.5 trillion by 2010, depending on the path assumed for discretionary spending.

Federal spending as a percentage of the economy declines from its current level under all three of CBO's alternatives for discretionary spending. Last year, federal outlays totaled just under 19 percent of GDP. In 2000, they will drop further, to about 18.5 percent. Over the next decade, CBO estimates, outlays will continue to fall slowly, reaching between 15.1 percent and 16.5 percent of GDP in 2010, depending on which assumptions are used.

Within the overall picture, the mix of Federal spending has changed significantly over time. Today, the government spends more on entitlement programs and less on discretionary programs as a share of GDP than it did in the past. Spending for entitlements and other mandatory programs (including offsetting receipts) rose from 4.9 percent of GDP in 1962 to 9.9 percent in 1999, while discretionary spending declined from 12.7 percent of GDP to 6.3 percent.

That trend continues in CBO's baseline projections. By 2010, mandatory spending (including offsetting receipts) is expected to reach 10.9 percent of GDP, as discretionary spending falls to between 4.2 percent and 5.3 percent. The growth of mandatory spending—at a projected rate of 5.6 percent a year—will be fueled by the two major health care programs, Medicare and Medicaid, which are projected to grow at average annual rates of 6.9 percent and 8.6 percent, respectively. Those growth rates are faster than the ones experienced in the past 3 years but slower than those of the early 1990's.

Discretionary spending is projected to increase at various rates from 2000 to 2010: the inflated baseline shows growth averaging 2.7 percent a year; the freeze baseline, 0.3 percent; and the capped baseline, 1.4 percent. Although total discretionary spending was virtually unchanged between 1991 and 1996, nondefense discretionary spending grew by 4.7 percent annually, while defense spending dropped by 3.6 percent annually. Over the following 3 years, nondefense spending increased by 3.8 percent, on average, and defense spending by 1.2 percent, leading to an average increase of 2.5 percent a year for total discretionary spending.

As a whole, Federal outlays (other than net interest outlays) are projected to rise by between 3.5 percent and 4.5 percent a year during the next decade (depending on which variation of the baseline is used). By comparison, total noninterest outlays grew at an annual rate of 3.4 percent over the 1991–1999 period.

Under each of the alternatives for discretionary spending, the Treasury would have enough cash on hand sometime between 2007 and 2009 to retire all of the federal debt held by the public. However, because some outstanding debt will not be available for repurchase, the Treasury would not be able to devote all such funds to that purpose. CBO's baseline simply assumes that the Treasury would invest all of its excess cash at an interest rate equal to the average rate projected for Treasury bills and notes and would receive dividend or interest earnings from those investments.

THE ECONOMIC OUTLOOK

In 1999, the U.S. economy continued to expand far beyond expectations—yet without any meaningful acceleration in the underlying rate of inflation. Most analysts expect the economy's growth to remain strong but to slow at least moderately from the 4.3 percent annual rate of the past 3 years.

CHANGES SINCE JULY

CBO's current economic outlook is more optimistic about the prospects for real growth than the one reported last July. Compared with the July projections, growth of real GDP and labor productivity is significantly higher, inflation as measured by the consumer price index (CPI) is unchanged, and interest rates are slightly higher (see Summary Table 6). Private-sector assessments of the economy's recent behavior reach the same conclusion—that the sustainable trends in the growth of labor productivity and real GDP are higher than previously thought possible.

SUMMARY TABLE 6.—COMPARISON OF CBO ECONOMIC PROJECTIONS FOR CALENDAR YEARS 2000–2010

	Estimated 1999	Forecast 2000	Forecast 2001	Projected 2002	2003	2004	2005	2006	2007	2008	2009	2010
Nominal GDP (Billions of dollars):												
January 2000	9,235	9,692	10,154	10,610	11,069	11,544	12,054	12,589	13,148	13,734	14,362	15,024
July 1999	8,964	9,351	9,751	10,159	10,583	11,027	11,508	12,017	12,554	13,113	13,695	n.a.
Nominal GDP (Percentage change):												
January 2000	5.4	5.0	4.8	4.5	4.3	4.3	4.4	4.4	4.4	4.5	4.6	4.6
July 1999	5.3	4.3	4.3	4.2	4.2	4.2	4.4	4.4	4.5	4.5	4.4	n.a.
Real GDP [1] (Percentage change):												
January 2000	3.9	3.3	3.1	2.8	2.6	2.6	2.7	2.7	2.7	2.7	2.9	2.9
July 1999	4.0	2.4	2.4	2.3	2.3	2.3	2.5	2.5	2.5	2.5	2.5	n.a.
GDP Price Index [2] (Percentage change):												
January 2000	1.4	1.6	1.6	1.7	1.7	1.7	1.7	1.7	1.7	1.7	1.7	1.7
July 1999	1.3	1.8	1.8	1.8	1.8	1.8	1.9	1.9	1.9	1.9	1.9	n.a.
Consumer Price Index [3] (Percentage change):												
January 2000	2.2	2.5	2.4	2.5	2.5	2.5	2.5	2.5	2.5	2.5	2.5	2.5
July 1999	2.2	2.5	2.5	2.5	2.5	2.5	2.5	2.5	2.5	2.5	2.5	n.a.
Unemployment Rate (Percent):												
January 2000	4.2	4.1	4.2	4.4	4.7	4.8	5.0	5.0	5.1	5.2	5.2	5.2
July 1999	4.2	4.3	4.6	4.9	5.1	5.3	5.4	5.5	5.5	5.5	5.5	n.a.
Three-Month Treasury Bill Rate (Percent):												
January 2000	4.6	5.4	5.6	5.3	4.9	4.8	4.8	4.8	4.8	4.8	4.8	4.8
July 1999	4.6	5.0	4.6	4.5	4.5	4.5	4.5	4.5	4.5	4.5	4.5	n.a.
Ten-Year Treasury Note Rate (Percent):												
January 2000	5.6	6.3	6.4	6.1	5.8	5.7	5.7	5.7	5.7	5.7	5.7	5.7
July 1999	5.6	5.9	5.5	5.4	5.4	5.4	5.4	5.4	5.4	5.4	5.4	n.a.
Tax Bases (Billions of dollars):												
Corporate profits: [4]												
January 2000	840	829	833	829	839	860	885	919	954	991	1,028	1,060
July 1999	724	687	725	758	783	814	844	880	915	950	982	n.a.
Wages and salaries												
January 2000	4,475	4,732	4,959	5,183	5,408	5,641	5,890	6,150	6,422	6,706	7,009	7,328
July 1999	4,410	4,632	4,810	4,995	5,207	5,431	5,670	5,922	6,187	6,463	6,751	n.a.

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

NOTES: Percentage changes are year over year. The projections for nominal GDP and the tax bases are not comparable because of definitional changes in the national income and product accounts (see Box 2–1 in The Budget and Economic Outlook: Fiscal Years 2001–2010).

n.a. = not applicable. [1] Based on chained 1996 dollars. [2] The GDP price index is virtually the same as the implicit GDP deflator. [3] The consumer price index for all urban consumers. [4] Corporate profits are book profits.

In CBO's current projections, real GDP grows for the next 10 years at an average annual rate that is 0.4 percentage points higher than was projected in July. Several factors account for that increase: 0.2 percentage points stem from a reassessment of how much of the recent surge in productivity will persist; slightly less than 0.1 percentage point results from a change in the projected growth of the labor force; and the rest reflects revisions in the measurement of real GDP.

Compared with real GDP growth, the growth of nominal GDP and the categories of income that are important for predicting revenues (corporate profits and wages and salaries) did not change as much from the July projections. The reason is largely that CBO's current projection of the growth of the GDP price index is lower. Furthermore, revisions to the historical data—along with revised outlooks for depreciation, net investment income from abroad, and corporate debt-service costs—have also reduced the projected growth of those income categories relative to the growth of GDP.

RECENT ECONOMIC PERFORMANCE

The economy has performed exceptionally well for several years, combining rapid growth and very low unemployment with declining inflation. Since 1996, the growth of real GDP has averaged better than 4 percent, compared with an average of about 3 percent since 1973. Because of those 4 years of rapid growth, the unemployment rate has fallen to 4.1 percent, its lowest level since January 1970. CPI inflation, excluding food and energy prices, had been running at about 3 percent per year earlier in the decade but was roughly 2 percent over the past year.

Much of the recent good news can be attributed to a surge in productivity growth, which has allowed the economy to grow faster without raising the rate of inflation. Low import and (until recently) oil prices, plus a number of other favorable but probably transitory developments, have also helped suppress inflation. However, domestic demand grew even faster than productivity—boosting employment, tightening labor markets, and raising concerns that recent growth rates may not be sustainable without sparking a rise in inflation.

THE FORECAST FOR 2000 AND 2001

The economy retains considerable forward momentum, but at some point, a slowdown from the recent blistering pace seems inevitable. If tight labor markets push up labor costs, the best news about price inflation may be in the past. Unless a faster rise in labor costs was offset by continued increases in productivity growth, consumer prices could move upward. Recovery in foreign economies could add to those inflationary pressures by boosting commodity prices and by strengthening foreign currencies relative to the dollar, which would raise import prices.

The Federal Reserve has already responded to the threat of accelerating inflation by increasing the Federal funds rate by 0.75 percentage points since June. Although those rate hikes may diminish the risk of inflation in the near term, financial markets seem convinced that further increases will occur this year.

For the next 2 years, CBO forecasts real GDP growth of about 3 percent, on average, and a slight rise in the underlying rate of inflation. That outlook would not cause the unemployment rate to change much in 2000 or 2001 from its current low level. The core CPI inflation rate (excluding food and energy prices) is expected to edge up slightly over the next 2 years from its recent pace of 2.1 percent.

In CBO's forecast, short-term interest rates average 5.4 percent in 2000 and 5.6 percent in 2001. The forecast assumes that the Federal Reserve will boost the federal funds rate by 0.5 percentage points during the first half of 2000 (in early January, financial markets expected at least that large an increase). Thus, the interest rate on three-month Treasury bills is forecast to reach 5.6 percent by midyear and remain there through 2001. The rate on 10-year Treasury notes is forecast to average 6.3 percent in 2000 and 6.4 percent in 2001.

PROJECTIONS FOR 2002 THROUGH 2010

CBO projects that real GDP will grow at an average annual rate of 2.8 percent during the 2000–2010 period. That growth compares with the slightly higher growth of 3.1 percent for potential output. Since the current estimated level of real GDP exceeds its potential level, actual GDP must grow at a slower pace than potential GDP to close the gap.

CPI inflation averages 2.5 percent a year after 2001 in CBO's projections, and the unemployment rate averages 5.0 percent. Short- and long-term interest rates are projected to average 4.8 percent and 5.7 percent, respectively, during that period.

UNCERTAINTY OF THE PROJECTIONS

CBO's baseline projections represent the midrange of possible outcomes for the economy and the budget, assuming that current policies are not changed. Actual budgetary outcomes, however, could be considerably different from those projections. Economic performance and other assumptions that deviate from CBO's baseline will surely lead to results that diverge from the numbers presented in this report. Policy changes will also occur that will alter outlays and revenues; CBO's projections do not attempt to take such changes into account.

Experience shows that although CBO's projection of the surplus for the coming fiscal year is likely to be within 1 percent of GDP in most cases, discrepancies can become more substantial over a 5-year horizon. CBO's 10-year projections have only been made since 1992, so it is too soon to assess their accuracy. But 10-year projections are likely to be less accurate than 5-year projections.

Many observers believe that a major structural change has taken place in the economy, and that belief influences CBO's projections. However, any transition to a "new economy" would have occurred only in the past few years, which means that little data about it are available from which to make projections for the next decade. Moreover, those data are insufficient to say for sure whether a structural shift has occurred or whether the economy has merely deviated temporarily from its underlying trends, as it has many times in the past. Under those circumstances, projecting the economy and the budget is even more uncertain than usual.

To illustrate the possible effects of differences from the baseline assumptions, CBO has produced budget projections under two alternative scenarios that make different assumptions. One (the optimistic scenario) assumes that the robust performance of the past few years will continue indefinitely and that Medicare and Medicaid spending will grow at a rate 1 percentage point slower than in the baseline. The other (the pessimistic scenario) assumes that the economy has simply experienced a temporary divergence from stable, long-term trends and will soon return to those trends—including even faster growth in Medicare and Medicaid. The projections that result from those two scenarios suggest a very wide range of possible outcomes for the budget: for example, the total surplus or deficit in 2010 could deviate from the baseline projections by $700 billion to $800 billion.

Under the assumptions of the optimistic scenario, the budget outlook would improve dramatically. If discretionary spending grew at the rate of inflation but there was no other action to cut taxes or increase spending, the annual on-budget surplus under that scenario would exceed $800 billion by the end of the decade, and the total budget surplus would exceed $1.1 trillion. Projected surpluses that large would imply that the Federal Government was holding huge amounts of nonfederal assets (more than $4 trillion). If discretionary spending was held to the lower levels implied by the statutory caps through 2002 or was frozen at the level enacted for 2000, surpluses would be even larger.

Under the pessimistic scenario, the on-budget surpluses that CBO is projecting in its baseline would never emerge. Instead, the on-budget deficit would rise to more than $290 billion a year by the end of the decade. The total budget deficit would be smaller; if discretionary spending was constrained for the whole decade to the level enacted for 2000, that deficit would stay under $100 billion.

CONCLUSION

The budgetary picture is bright. Projected surpluses are much larger than the ones that CBO projected last July. The improved picture largely results from CBO's updated economic outlook. But actual budgetary outcomes could be considerably different from the projections. Economic performance and other assumptions that differ from CBO's baseline will lead to results that diverge from the projections. Policy changes will also occur that will alter outlays and revenues; CBO's projections do not attempt to account for such changes.

Although the improved budget outlook over the next 10 years brightens the long-term outlook, problems lie not far beyond the 10-year horizon. Between this year and 2030, the number of retirees will grow by 80 percent, but the number of workers will increase by only about 10 percent. Ultimately, it is not the size of the balances in the trust funds that will limit the ability to meet long-term obligations but the size of the economy.

Chairman KASICH. Let me just then ask you, Mr. Crippen, we were in the hearing with Mr. Lew. I was making the point that there are no programmatic changes in either Medicare or Social Security that extends the life of these programs; is that correct?

Mr. CRIPPEN. I believe so, but again, we have not examined the President's budget thoroughly, so I cannot tell you what all of the programmatic changes are.

Chairman KASICH. Let me ask you this: If you put IOUs in the funds, does that extend the life of these programs?

Mr. CRIPPEN. No, it does not. The trust funds may look better, but it does not change the program or the important variable of how much of the economy is being dedicated to those programs.

Chairman KASICH. Your report really reflects—let's talk a little bit about this demographic situation in terms of Social Security and Medicare. How about putting into perspective what happens the longer you wait—just kind of paint the picture of Medicare and Social Security, understanding that—I kind of look at Social Security as a program where you can do a reform, where you can slow the growth in benefits, but on the other side, if you give people private accounts, they have the opportunity over time to more than make up for what they lost in government promises, which are empty anyway.

But there is a good news story there. Minority people really get hurt at all, I think that is a silly thing to even say. The only people that get a little bit less, at least under the plan I have that I think will ultimately be—what will be adopted to fix Social Security, this narrow range of baby boomers, because their private accounts cannot—well, they could actually grow fast enough to make up for the slowing in the growth rate in benefits, but for anybody, you know, under the age of 40, they are going to make out like bandits, and if you are young, you are going to do terrific under Medicare.

So there is a good news story, but I can't figure out the good news story under Medicare because the population growths are high, and I don't know how you balance these out.

Why don't you talk about the difference, the need to get onto those programs, and what we are really facing. Paint a picture for us.

Mr. CRIPPEN. Maybe one way to think about it, Mr. Chairman, is that if we are truly going to fund Social Security and maybe Medicare, our generation should pay twice: once for our parents and once for ourselves. By paying twice, we would save enough so that the economy could grow enough to keep us from commanding more from our children in the future than we are paying to our parents today. At some point, some generation will need to pay twice.

Now, we can spread that out. We can certainly leave more of the burden on our kids by borrowing and not reforming the programs any time soon. We could try and shift some costs onto our parents by cutting current benefits, but no one is talking about that. Essentially, the question is, where do you want to place that burden for finally paying twice and funding Social Security?

Chairman KASICH. Can't we just grow out of this?

Mr. CRIPPEN. No. Part of the problem is that in order to grow at all, we need to save more, which means our generation has to save more now and cut current consumption. Be it public consumption through the government or private consumption, we need to cut consumption now and save more so the economy can grow faster.

Chairman KASICH. Isn't it true also if you have a Social Security System that pegs you to wages and prices, that, in fact, the faster we grow, in a way the deeper the hole is we get ourselves in? Is that not correct?

Mr. CRIPPEN. It is certainly correct because we index Social Security's initial benefits to real wage growth, although there is a lag, which helps, of course, in the process. You could change the objective of the Social Security System from one of maintaining a certain share of earnings to one of preserving purchasing power. If, for example, you changed the indexation of the initial benefit from real wage growth to price increases, you would pretty much solve the problem of the long-term actuarial balance in the Trust Funds.

Chairman KASICH. That is precisely the proposal I have, but it is also offset, however, by the fact that you can have a private account that you would be able to earn money in, and the longer you get that account, the more money you earn. The longer it takes us to enact it, the less money you earn. So that is why we ought to get about it today.

Mr. CRIPPEN. The more you can increase savings, whether private or public, the faster the economy will grow and the better the fraction that I described will look.

Chairman KASICH. Tell me about Medicare a little bit.

Mr. CRIPPEN. Medicare is a different story, of course, because Social Security is both simpler on its face and also a lot easier to project into the future. We know that everyone who is going to collect Social Security in the near term is alive today. And we know roughly how long they are going to live and what their wage patterns are going to be. Projections are thus much easier to make, and the program is also relatively stable. In that sense, there are only two or three variables or levers that you would pull for policy.

In the case of Medicare, and to a lesser extent Medicaid, we not only have growth in the number of recipients driving the numbers, as is the case with Social Security, but we also have the growth in prices of medical care, a rate that is often higher than that of the general economy, and changes in medical technology and utilization of medical resources. So you have three big components driving Medicare spending and only one, in effect, driving Social Security. And it is those two other components—utilization of resources through technology, or intensity of use, and the prices of medical care and pharmaceuticals that are hard to predict and that drive spending for the program. And it is those components that will cause Medicare to eventually spend more money than Social Security, and it is those that, as you are suggesting, are probably necessary to get us through to programmatic reform. Simply changing one of those three streams—namely, trying to control prices—does not do you much good in terms of controlling the overall cost.

Chairman KASICH. Mr. Spratt.

Mr. SPRATT. Dr. Crippen, you told the Senate Appropriations Committee, I believe, on January 26 that to have a freeze on appropriations for a period as long as 10 years would require, in your words, unprecedented restraint. Let's take two of the paths you have plotted for discretionary spending and see if there is any precedent for the level of expenditure of cuts that each of these paths would take.

For example, you assumed—you really had to assume because you are pretty much bound to assume that Congress will follow its own law, that Congress would track the BBA or return to the balanced budget agreement and in 2001 drop spending, discretionary spending, to the level of the cap set by the BBA. As I recall your report, you indicated that outlays this year, discretionary outlays, by your calculation was $603 billion. If we return to the caps, outlay caps, in 2001, what sort of outlay cut would be required between this year and next year?

Mr. CRIPPEN. Roughly $30 billion.

Mr. SPRATT. Roughly $30 billion.

And BA, budget authority, that would be, I take it, probably 10 or 15 billion more.

Mr. CRIPPEN. I think because of the advance appropriations, it may actually be slightly less this time.

Mr. SPRATT. Around $30 billion for both then.

Now, is there any precedent for that?

Mr. CRIPPEN. I was just looking back, Mr. Spratt, to one of the few times we have had absolute cuts—in 1981 or 1982—and I do not think it was quite that much. So probably there is no precedent.

Mr. SPRATT. That was one year.

Mr. CRIPPEN. Yes.

Mr. SPRATT. Now, the next year, from 2001 to 2002, if we were to track the caps, we would have to go down again in outlay terms by about $10 billion more because the cap drops from around 580 to around 570 in 2002.

Mr. CRIPPEN. Yes.

Mr. SPRATT. That would mean we would have to take a $40 billion reduction in 2002, and there is no precedent for that then, not even 1981.

Mr. CRIPPEN. Probably not to that extent. Total discretionary budget authority and outlays have never gone down as much as you just described, although nondefense discretionary spending dropped in the 1981–1982 period by about those same magnitudes.

Mr. SPRATT. If we had a freeze in discretionary spending over a period as long as 10 years, what would be the effect on real spending, real discretionary spending, at the end of that period of time?

Mr. CRIPPEN. It would be a diminution of about 25 percent in real terms.

Mr. SPRATT. Twenty-five percent.

Mr. CRIPPEN. Yes.

Mr. SPRATT. If we held defense spending constant against inflation, harmless against inflation, over that 10-year period of time, what would be the real spending decrease in nondefense spending at the end of the 10-year period of time?

Mr. CRIPPEN. Outlays in 2005 would be 21 percent lower. Over the 10 years, it would be much more than that.

Mr. SPRATT. Our calculation was roughly 40 percent. Does that sound right to you?

Mr. CRIPPEN. Yes.

Mr. SPRATT. Is there any precedent for that kind of cut in discretionary spending?

Mr. CRIPPEN. Not that I am aware of—certainly not for the cut over the 10-year period.

Mr. SPRATT. We have done a calculation of nondiscretionary spending over the last 20 or 30 years, and we found that it has grown at a pretty constant rate, real and nominal, over that period of time. Even when there were caps, as there have been since 1990, there has been a fairly steady incremental growth in discretionary spending, so it would truly be unprecedented restraint to have that level of cut in nondiscretionary spending.

Mr. CRIPPEN. It is certainly true, Mr. Spratt, that, on average, over the period you were citing—say, from on—has discretionary spending grown. But growth has not been consistent; there is no steady increase. In some years, spending has been down, in some years up. We have had cuts in nondefense discretionary spending, as I said, in 1981 and 1982 of as much as 12 percent in real terms. So the pattern is variable. I think it helps to reiterate that this is discretionary spending; it does change from year to year, with no overall pattern. So that is why in my testimony I said that none of these baselines are really very satisfying because they do not tell you what your needs are going to be for next year, nor do they tell you what programs no longer deserve your support. It is really not a particularly satisfying exercise to have a 10-year baseline for discretionary spending. Discretionary means just that, and I think the history of such spending shows that it has, indeed, been used that way.

Mr. SPRATT. With respect to Medicare, which I mentioned a while ago, you have assumed continued cost growth, but at a restrained or lower level than historically has been the case with Medicare. Do you have some concern about the maintenance of this historically low rate of growth in Medicare and Medicaid, the two big health care entitlements?

Mr. CRIPPEN. Our concern is not about our projection; obviously, we can be wrong about the final numbers. But if we begin to add spending in the intermediate term, that is, in the next 10 years, it is going to change those programs in ways that we cannot determine today. Again, utilization rates for pharmaceuticals, for example, and technological changes are very hard to predict. My guess is that actual rates of growth for Medicare and Medicaid will be higher than the baseline rates of growth we have projected. But we are not too concerned that the roughly 6.6 percent growth, on average, over the next 10 years would be exceeded greatly under current policy or current laws.

Again, growth in those programs is going to be driven not so much by my generation's retirement but by increases in utilization and prices. So, although those are harder to project, we are not uncomfortable saying that the 6.6 percent is going to be twice that or half that. After my generation starts to retire, those numbers will be much, much different, of course.

Mr. SPRATT. Do you think the projection is firmer now than it has been in the past because more of the categories of benefits are in prospective payment form rather than reimbursement form?

Mr. CRIPPEN. That has certainly helped; it makes it a little easier to project more accurately. History is a guide, not an absolute. Last year, we had a 1 percent reduction in Medicare spending. Nobody believes that that drop is going to be repeated this year or any time in the future, but nobody predicted it was going to happen either. If we based our projections solely on last year's experience, we would have obviously a very bad prediction of what future costs are going to be. That is why we use a number of years of program spending in determining our projections. Our current outlook of 6.6 percent annual growth—we are comfortable with that.

Mr. SPRATT. Still a little iffiness in that assumption, too?

Mr. CRIPPEN. Absolutely.

Mr. SPRATT. Finally, with respect to Social Security, we have had this discussion before. The President proposes taking $300 billion out of the general fund and over time putting it into the Medicare fund. Mr. Kasich calls these IOUs. Legally, they are bonds backed up by the full faith and credit of the United States Government, and so you might call them an IOU, but the Administrator, instead of being a political supplicant when his cupboard runs bare, is a secured creditor. He has got the strongest claim against the Treasury that you can have in our country. That makes it more than just an IOU. But economically if this is a net addition to national savings, if that $300 billion contribution is an offset against money that would otherwise be spent and is instead used to pay down national debt or to buy equities in the stock market, invest in the markets, doesn't that do something for the life insolvency of Social Security?

You said for us to grow out of the problem, we have got to save. If we save more, we can grow more. Wouldn't this be a net addition to national saving that might promote growth and therefore help Social Security?

Mr. CRIPPEN. In the way you have put the question, absolutely. You are assuming that it is a net addition to the reduction of debt held by the public. If that is the case, it would certainly add to national savings and could enhance economic growth. It would help the denominator of that fraction I mentioned, by helping to grow the economy.

What we have seen in the past, as in last year's budget, is a situation in which the transfers do not really contribute to a net reduction in debt held by the public. The question is, does the transfer contribute to a reduction in debt? If so, then it helps with saving.

Mr. SPRATT. Thank you very much.

Chairman KASICH. We have got a vote on—this is the 10-minute warning. We will go over and vote, come back right away, and finish the hearing. Thank you. We will stand in recess.

[Recess.]

Chairman KASICH. Why don't we go ahead and start. I would like to recognize Mr. Smith for 5 minutes.

Mr. SMITH. Mr. Chairman, thank you. And I think maybe the question, Mr. Crippen, with the combined challenge of Social Security, Medicare and Medicaid, has CBO calculated the increased obligation that will be put on future generations in terms of either payroll or income tax increases, if we make no changes in Medicare or Social Security?

Mr. CRIPPEN. By 2030, which is when roughly the end of the baby-boom generation hits retirement, the amount required to fund obligations to the elderly will be twice what is needed today—that is, 14 percent of GDP instead of 7 percent. What does that mean? In today's terms—if that was the situation you were facing as you write next year's budget—it would mean that you would have only $400 billion left to spend on everything else. To put it another way, you would have to raise taxes by $600 billion next year to fund those obligations. We would go from taking 7 percent of the total output of the economy to taking 14 percent. You could also raise taxes, increase borrowing, or cut benefits. The policy that is chosen will affect which generation is paying for what. As I said, one way to think about it is that my generation needs to pay twice, once for our parents and once for ourselves. In order to do that, we obviously have to save a lot more and forgo consumption, whether it is through the government or by ourselves. Of course, we can put that burden on our kids by ignoring the problem for as long as we can or by borrowing more. It really has to do with which generation you want to pay for those benefits.

Mr. SMITH. A combination of your office and Social Security actuaries show that without any program changes, within 40 years we would have to approach a 40 percent payroll deduction to pay for Social Security, Medicare, and Medicaid. I am sorry Mr. Spratt isn't here. With your permission, Mr. Chairman, I am going to just shout. Mr. Spratt suggested that it is inconceivable that we can have a freeze and that we should increase spending with inflation. But it is obvious that we don't increase spending consistent with inflation. Actually we see a downturn in spending compared to the red line of inflation.

Mr. Spratt, I was just saying that maybe your point that it is going to be tough to have a freeze, and saying that we should automatically increase spending consistent with inflation is unnecessary. What I was pointing out on this chart is that we haven't increased spending with inflation and it isn't necessary to increase spending with inflation.

Mr. Crippen, I would like to ask you a question on an issue that is coming up before Rules Committee today, and that is a biennial budget. With our performance record on not doing a good job guessing what the revenue is 2 years down the road, plus the increased power that it gives the administration, would you say that having a biennial budget tends to shift some power over spending from the legislative branch to the executive branch?

Mr. CRIPPEN. I would have to confess that I have not really thought about it in those terms. I think it does shift power within the Congress, among the budget committees, the appropriations committees, and the authorizing committees, although I am not quite sure how.

My first reaction is that I do not think that a biennial budget would shift power much. Presumably, the administration would present a budget every 2 years instead of every year, so congressional activity in the second year would be enhanced. One of the things I was talking about with some of your folks earlier was that the result of biennial budgeting will probably be determined by what the media decides to cover or what becomes interesting and newsworthy. In the second year of the cycle, you could see a lot of oversight by appropriators and authorizers, and that would be the news, as opposed to the President presenting his budget or the State of the Union address.

Mr. SMITH. Are we good enough guessers on revenues 2 years ahead of time to accurately have a 2-year budget?

Mr. CRIPPEN. Clearly, we would have to update the outlook at the halfway mark if you wanted to make adjustments at that point. We have had trouble in the recent past projecting revenues for a 2-year period, but last year was almost dead on. This year, we are hoping we will be pretty close, too.

Mr. SMITH. Last year was dead on on revenue projections?

Mr. CRIPPEN. Very close.

Mr. SMITH. Whole 12 months ahead of time?

Mr. CRIPPEN. Not the whole 12 months ahead, but closer to the end of the year. We are now doing 10-year policy-based projections where we used to do 5-year ones. We are more comfortable with 2 years than we are with 5 and 10. So I think our projections are accurate enough to do a 2-year budget. Are they going to be precise? No. You are going to want to review and perhaps adjust things 12 months down the road.

Mr. SMITH. Thank you.

Chairman KASICH. Ms. Rivers, you are recognized.

Ms. RIVERS. I was listening very carefully when you were answering Mr. Smith's questions about Medicare and Social Security and the long-term solvency of them, and you said at one point we better by saving a hell of a lot more now than we are. If you look at it from that perspective, what would the effect of, say, the $1.7 trillion tax cut Governor Bush is proposing or even the $8 trillion proposed by Republicans in the House, what would the effect of that be in our efforts to deal with Medicare and Social Security over the long haul?

Mr. CRIPPEN. It would depend on what your assumption is about the alternatives.

Ms. RIVERS. Loss of revenue; what would the loss of that kind of revenue do?

Mr. CRIPPEN. If it were to be spent on something else, it might have no effect——

Ms. RIVERS. If it were not, if it were going to be used to pay down the debt.

Mr. CRIPPEN. If we saved all of it, as I said in my testimony, by the end of the decade we could pay off the debt, and the additional savings would help Social Security.

Ms. RIVERS. So having a tax cut would make it harder, and not having a tax cut and not spending the money would make it easier to deal with Medicare and Social Security?

Mr. CRIPPEN. Let me retreat into economist talk. The one thing most economists agree on is that if you save the surpluses, the economy will grow faster. If the economy grows faster, it will be easier to pay the obligations owed to my generation. After that, there is a division of the house. A tax cut of one kind might help economic growth; a tax cut of another kind might not. As the Chairman pointed out, there may be spending programs that help economic growth, and there are certainly those that probably do not. You cannot make a broad-brush statement—or, rather, I am unwilling to make the broad-brush statement that you just made.

Ms. RIVERS. The other question I have, this is my sixth year, and I was in State government before that, and the idea that we can bring down spending by large amounts by ferreting out waste, fraud and abuse, which is one that gets floated all the time. Do we have any historical data that suggests how successful these efforts have been in the past?

Mr. CRIPPEN. We have no data that you would find satisfying; they are not very precise. Let me use one example from recent history, and that is in Medicare. It is quite apparent that the efforts the Clinton administration has undertaken to increase compliance with Medicare regulations have had a profound effect on spending. How much is open to question because we do not know exactly how much of the drop in spending is due to those efforts and how much is the result of a change in——

Ms. RIVERS. But we also know that the legacy of that broad-based account, that sort of meat-axe approach, was that home health care providers, hospitals that were doing nothing wrong, that were not operating in any way in a wasteful, fraudulent or abusive manner, found their overall costs cut, and they were unable to deliver services. So when you have a flat cut as opposed to ferreting out specific problems, don't you create other kinds of consequences?

Mr. CRIPPEN. You can; however, the waste, fraud, and abuse effort—and I use those terms advisedly—for Medicare was not really the same thing as the cuts in payments implemented by the Congress and the Balanced Budget Act. The payment cuts had a different purpose—some were intended to save money and some to change the payment policy. The assault, if you will, by the administration on noncompliance in Medicare did not have anything to do directly with the BBA's changes. The things they have done to enforce compliance have become quite public.

Let me give you an example. Medicare had a long history of aggressive billing by hospitals for particular conditions—that is, the more expensive conditions were showing up more often. After the administration began their compliance efforts, that trend reversed.

Ms. RIVERS. My understanding is the cuts in home health care were specifically directed at abuse in a minority of States, and that there was a meat-axe approach used to cut funding across the board for everyone in an effort to deal with these specific States, which is sort of what is being proposed for the budget. Make a big cut, everybody has to live with it, and maybe we will get the fraud and waste and abuse; and if we don't, well, we will still save some money. Isn't that analogous?

Mr. CRIPPEN. There could be some unfortunate outcomes when spending is cut across the board. But spending restraint does not have to mean an across-the-board cut. For instance, our freeze baseline variation, or even the capped baseline version, is only a top-line amount. It does not assume that spending for every program is frozen at this year's level. It just assumes that in total, when you add up all spending for the year, that it is frozen roughly at the 2000 level of spending. That is why we call such spending discretionary, so that it can go up and go down for particular programs. Our frozen baseline variation is just a top-line assumption; it does not assume across-the-board cuts in individual programs.

Ms. RIVERS. The last question I have, since I have always had reservations about the projected surplus, I wonder if the cartoon you chose to bring us today is to remind us we shouldn't be too sure about your projections either?

Mr. CRIPPEN. That is certainly true. I brought it because I thought it was somewhat appropriate to our discussion. In the volume we just released, "The Budget and Economic Outlook: Fiscal Years 2001–2010," Chapter 5 is entitled "Uncertainties." In it, we highlight a number of the factors that we are unsure about and, in fact, develop two different scenarios of assumptions about spending and the economy that could produce surpluses greater than we are now projecting or smaller than we anticipate. The farther out you project, the more uncertainty there is; 10 years is a long time to project anything—the economy or government policy.

Ms. RIVERS. As we look at decisions that have long-term consequences, how firm is the footing on which we are making decisions that are going to play out 5 and 10 years from now?

Mr. CRIPPEN. Well, let's take Social Security as an example. We know a little more about Social Security in the future than we do about many other programs because we know, for instance, roughly how many people are now alive and are going to retire. And we know about factors that will influence spending growth in such programs over the long term. But short-term projections of spending and tax revenues are more uncertain. Discretionary spending has gone up, then gone down; taxes have gone up and gone down. Of course, the politics of an issue might make it difficult to reverse directions or do something else, but clearly, the history of the budget shows that we have had both tax increases and tax cuts, spending increases and spending cuts—for example, the BBA's home health care.

Now, I am not saying that you should hesitate to do something because 10 years from now we do not know what the situation is going to be. There may be current spending needs that should be funded or tax cuts that would be appropriate and that indeed, might help long-term programs by growing the economy more quickly. The uncertainty of the projections, although they might suggest the need for caution, obviously should not prevent you from taking action you think is appropriate.

Ms. RIVERS. Thank you very much.

Thank you, Mr. Chairman.

Chairman KASICH. Mr. Hoekstra is recognized.

Mr. HOEKSTRA. Good morning.

Mr. CRIPPEN. Good morning.

Mr. HOEKSTRA. Words make a difference. Benchmarking makes a difference. I chair a subcommittee of oversight, and we have oversight over the Education Department, about $35 to $40 billion of discretionary spending annually. They also manage a loan portfolio that runs into the billions of dollars. In 1998, they couldn't audit their books. I don't know if you factor that kind of information in or not when you put these numbers together, but you have got an agency out there that makes up $35 billion of your discretionary number, and they can't really tell us how much money they spent or where they spent it.

If we benchmark that Department against the Pentagon, it is kind of like, hey, they are doing a great job. If we benchmark them against the private sector, and we just met with Ernst & Young yesterday, they said their performance for 1999, while improved, would still be somewhere in the C minus to D minus range, and if they were listed on the Securities and Exchange Commission, they would be—or if they were listed—they would be in trouble with the Securities and Exchange Commission for that kind of performance.

The question I have is your CBO baseline budget projections, assuming that discretionary spending is frozen, there could be another title on there, it saying that perhaps you could deliver the same services at these dollars or if you had roughly a 2, 2½ percent productivity enhancement; is that correct?

Mr. CRIPPEN. Yes, absolutely.

Mr. HOEKSTRA. Because one of the things that—I have got a lot of automotive suppliers in my district, and I can tell you that none of them build in discretionary—excuse me—build in automatic inflationary increases to any of the automotive companies. A lot of them actually go in the other direction. If they are building a product today that they are getting a dollar for, they have got contracts into the future that say next year you will deliver an improved product with enhanced features, and you will do it for 95 cents, and in the third year of the contract you are going to be doing it for 92 cents.

So how do you—the Education Department, I take a look at them and they tell me how they try to keep their books, and it sounds like a monastery with monks copying Holy Scripture in 500 or 600 A.D. They close their books and they bring in outside contractors to manually reconcile their books and bring it together, and, again, when you benchmark that against the private sector, it is like, wow, why do you use the term "freeze" instead of "productivity enhancement"? Could they be identical?

Mr. CRIPPEN. Sure. If you had an adequate productivity increase, you could have the same output even though spending was frozen. It is a nomenclature that we did not just develop this year—it has been around for a while. Let me piggyback some comments on what you said. I mentioned earlier that we do not account for any productivity increases, although I suspect there are some in the public sector. They may not be as great, perhaps, as the private-sector examples you are citing, but there should be some. I can look around CBO and see increased productivity in the fewer clerical support people we need and the better use we are making of resources in other areas.

But a freeze does not tell you about the programs that should or should not be funded; it just suggests a number to look at. And what we are doing with a baseline is trying to give you a set of numbers that over 1 year or 5 or 10 years gives you a sense of where we are headed. It is just very hard to do with discretionary appropriations because you change them from year to year, which is the nature of the beast and should be.

The question is, what is the best measure, or benchmark, for discretionary appropriations? It may well be that the freeze baseline variation, which holds spending to last year's enacted appropriations, is the best benchmark, at least for the near term, because it gives you the most recent programs you funded, presumably deservedly, and it also gives you the last analysis anybody did of the existing system.

I think any baseline projecting discretionary appropriations over 10 years is a very iffy proposition. But whether you start with last year's appropriation levels as your base or whether you assume some productivity increases, it is important to recognize that underneath that big number we give you are lots of programs that you need to examine, presumably on an annual basis. That is why they are discretionary.

Mr. HOEKSTRA. When I take a look at—only in government would we think that benchmarking off of last year and putting in an automatic inflationary increase is the most reasonable way to go. That is not the world that my constituents live in in the business world. They take a look each and every year. They take a look at new technology and say, hey, if we incorporate this new technology, we will be able to deliver a better quality product at a higher service level at a lower cost, and so overall we can give a better degree of service to our customers, and we will lower our costs and our prices at the same time.

Mr. CRIPPEN. The Congress enacted a program—I think, 7 years ago—under the Government Performance and Results Act that has spent the past 7 years developing program objectives and ways to measure whether those objectives are being met. I believe the first round of reports from the agencies are due to the Congress at the end of next month. So there should be ample material there for the Congress to take a look at to see how well the programs are performing, what are their objectives, how are they doing. You could also have the departments come up and talk to you about the programs. In that sense, you have, I think, a very new and very good opportunity to do what your private-sector constituents do.

Mr. HOEKSTRA. Thank you.

Mr. GREEN [presiding]. Mr. Minge, questions?

Mr. MINGE. Thank you, and thank you, Mr. Crippen, for being here. I would like to focus on the question of debt reduction and how that factors into the projections and the activity that is currently taking place here in Congress. And it is my understanding that you and Chairman Greenspan really—the consensus position of the economists and public policy experts that have been analyzing the Federal budget is that the surpluses that we are beginning to realize have contributed to holding down interest rates to economic growth and to the soundness of our economy, and I am assuming that you share this position.

Mr. CRIPPEN. Yes.

Mr. MINGE. It is also my understanding that you recognize the risks inherent in multiyear forecasts, especially 10-, 15-year forecasts, and I understand if a 10-year forecast like we are talking about at this point is off by 1/10 of a percent each year, that the cumulative effect over that 10-year period on the Federal budget would be in excess of $200 billion. So either we would have $200 billion more or, heaven forbid, $200 billion less. And we have seen some fairly significant swings here in the forecast, as you already recounted, in the last 7, 8 years, and it has all been on the upside, so it gives us reason for optimism, but you have tried to maintain some sort of pessimistic estimates in your own forecast.

My concern is that if we were to come up with a bold new entitlement program as opposed to even just a modest expansion of the current program and lock that in place in reliance on this 10-year forecast, you would probably caution us that that is not a prudent move if we are committed to having a surplus over this 10-year period of time. Would I be correct in that?

Mr. CRIPPEN. I think so. It depends on the size and the nature of the entitlement program you are talking about. If the range of expenditures was $10 billion to $100 billion a year, you would have to worry about it. If expenditures were pretty well circumscribed—$10 billion to $15 billion a year, for example—and you could predict with some certainty that that spending would not grow quickly to $100 billion, you would have a different story. If you were proposing a new entitlement program that would spend $100 billion a year, you would certainly have to be very cautious about how much of the surplus you would have left to dedicate to paying down debt.

Mr. MINGE. And certainly many of us share that concern, and I know this is a part of the debate over prescription drug coverage, can it be contained, will it grow, how can you contain it and so on.

And one other aspect of this is on the revenue side, and I expect that you would share that same concern if a new tax approach was locked in, what is the impact on that over a 10-year period of time on the revenues that are needed to finance Federal operations.

Mr. CRIPPEN. As I said to Ms. Rivers earlier, the one thing most economists do agree on is that paying down the debt is generally helpful for the economy. After that, there is no consensus on whether cutting taxes or increasing spending would be just as or more helpful. In fact, there may be spending on education, for example, that could help the economy grow more than would paying down debt. There could be tax cuts that might help the economy grow more. But economists as a group do not have a clear view of exactly how that would go.

One thing I did say to Ms. Rivers, too, is that because of the uncertainty——

Mr. MINGE. I was here when she asked those questions, so rather than revisit those, what I would like to conclude with is an observation based upon what I have seen at the State level. In Minnesota, and I expect in many other States, as these surpluses have rolled into the State treasuries, they have established rainy day funds, first to make sure that they have a hedge against a bad year, if they have a bad year the next year or two, and then secondly, they have had some modest program expansion. Third, they have had tax refunds, which have been curious to me because instead of making changes in the tax code that would be carried forward from year to year, they start by having a rebate. And I am just wondering if you could give us any observation on whether or not what the States have been doing is something that we should be paying more attention to as opposed to spurning that and insisting on long-term changes in the Tax Code itself, and certainly before these surpluses have even begun to roll in.

Mr. CRIPPEN. It is an excellent point but not, unfortunately, one that I know much about. We may well have some folks in CBO's

State and local budget analysis section, though, who pay more attention to it. I have read that States are anticipating cutting taxes again this year, because, as you say, surpluses are growing. I have not thought about the different effects of rebates versus changing the Tax Code, but we could certainly take a look at that.

[The information referred to follows:]

Tax Actions Taken By States in Times of Surplus

INTRODUCTION

Facing sluggish economies in the late 1980's and early 1990's, states took a number of actions that bolstered their finances and created opportunities for present surpluses. States established rainy-day funds, or some variation of them; they cut spending and reformed many of their programs; and a number of states increased taxes. Because of the danger of overextending themselves in the future, states did not take dramatic actions to reduce early surpluses. Instead, they hedged against overcommitting themselves by using surpluses in limited, yet productive ways-by increasing rainy-day funds, spending funds for one-time infrastructure improvements or program formulation, and enacting limited or phased-in tax reductions. However, with surpluses occurring year after year, states began to reduce taxes in various ways, including multiyear cuts in tax rates and other adjustments to deductions and exemptions. In 1999, 31 states cut income taxes in some way; 28 states will reduce them in 2000. Some states have also continued to provide periodic tax relief through rebates.

TAX REBATES AND ONE-TIME RATE REDUCTIONS

Tax rebates can provide a one-time tax reduction without changing the underlying structure of state taxing authority. Through rebates, states give money back to taxpayers, although they may create a Federal tax liability for people who itemize their deductions if they return the money through a state income tax rebate. Consequently, some states base their rebates on sales taxes. Such rebates take a number of forms but are usually available to all state residents and, on occasion, to some out-of-state residents who can prove that a sales tax liability occurred. Sales tax rebates are often tiered amounts, ranging from $30 to $500 in some cases, depending on the state and the total amount designated for rebates; they are provided to most adult residents of the state. In most instances, states use their own income tax data to provide the rebates, although on occasion, they may use additional Federal databases from the Internal Revenue Service or the Social Security Administration. For rebates based on income taxes, the state may require a simple form, or it may determine the amount on the basis of existing records. However, income tax rebates are not always based solely on income tax liability; marital and household status may be a factor as well. Six states will provide tax rebates or one-time rate reductions in 2000 for prior tax years.

Constitutional Rebates. In Missouri and Colorado, provisions of the state constitution require rebates when revenues exceed either estimates or some other defined level or cap. Missouri will rebate $178 million in taxes because revenues exceeded a cap on growth established in state law. Colorado will rebate $679 million because of constitutionally established limits on revenue and spending growth. Oregon may have rebates in the upcoming year, but because the state budgets biennially, rebates would not occur until the end of the 2-year budget cycle.

Legislated Rebates. Three other states have provided rebates through annual legislative action, despite no governing requirement in existing law or in their state constitutions. Connecticut, Minnesota, and Wisconsin have rebated $118 million, $1.3 billion, and $700 million, respectively. To avoid a Federal tax liability for taxpayers and an adjustment to a prior year's itemized deductions, the states returned that money in the form of sales tax rebates. (Another rationale for providing sales tax rebates is that they can reach a larger part of the population.) Before its most recent rebate, Minnesota had provided tax rebates based on the amount of property taxes that an individual had paid. A person could claim the rebate by completing a line on his or her income tax form.

TAX REBATES

[In millions of dollars]

State	Rebate year 1999	Type [1]	Rebate year 2000	Type [1]
Colorado	530	I	679	I*
Connecticut	102	I	118	S
Minnesota	468	P	1,300	S
Missouri	319	I	178	I
Oregon (Biennial)	167	I	n.a.	n.a.
Wisconsin	n.a.	n.a.	700	S

[1] I = income tax rebate (for Colorado in 2000, this amount also includes a business personal property tax rebate, as indicated by the asterisk); S = sales tax rebate; and P = property tax rebate.

One-Time Rate Reduction in Ohio. Ohio adjusts its income tax rates annually on the basis of prior-year surpluses, a unique way of providing tax relief on an annual basis. After meeting a number of funding requirements for rainy-day funds, special reserves, and spending priorities, the state determines the total surplus accruing at the end of the year. That surplus is returned to taxpayers by adjusting baseline tax rates. Each tax bracket is reduced by the percentage that the prior year's surplus exceeds projected revenues for the upcoming year. By that method, Ohio will provide $293 million in tax relief by reducing its baseline tax rates by 3.6 percent. That approach accomplishes the same goal as more common rebate programs; however, it can create problems with public perceptions. A large surplus one year might necessitate a large cut in the tax rate, whereas a lower surplus the following year would cause tax rates to increase-even though those rates are lower than they would have been under the baseline estimate.

Unlike permanent reductions in tax rates or changes to exemption status and deductions, tax rebates do not automatically recur. Rather, they depend on excess revenues and most often require some form of legislative action. They also allow lawmakers to provide a form of tax relief without raising the possibility that tax rates will have to be increased at some later date when spending pressures increase or revenues fall.

OTHER TAX CHANGES

Although tax rebates may offer states greater flexibility in the future compared with permanent changes to their tax systems, recurring surpluses over the past few years have led many states to make such changes. Fifteen states made significant net tax cuts in 1999, after 21 states took similar action in 1998. Since income and sales taxes provide the majority of state revenues, it is not surprising that those taxes saw the greatest reductions. Nine states cut income tax rates for the 2000 tax year, and seven states raised exemptions or the amounts allowed for standard deductions. Twenty-three states made some type of reduction in sales or use taxes.

TRACKING CHANGES IN STATE TAX POLICY

Both the National Association of State Budget Officers and the National Conference of State Legislatures publish annual updates on state tax and budgetary actions. The Center for the Study of the States (located at the State University of New York at Albany) also publishes regular summaries of states' revenue experiences and changes in their tax laws.

Mr. MINGE. I would appreciate receiving some advice and guidance from CBO on this because the States have had these surpluses for several years, and so they have struggled with this, and at this point they are beginning to change their tax codes. But at least the first couple of years my observation is that they were focusing on rebates and other approaches to this, and similarly they were cautious about embracing new programs which under at least current leadership it doesn't appear we are at much risk of doing. So that, I think, would be helpful. The States, so to speak, are a laboratory for experimentation, and we can certainly learn from watching what they have done and whether or not it has been successful.

Mr. CRIPPEN. Fortunately for the citizens of Alaska, they have been giving back revenues for a long time. We have some examples.

Mr. MINGE. Thank you very much.

Mr. GREEN. Mr. Gutknecht, please.

Mr. GUTKNECHT. Thank you, Mr. Chairman.

Thank you, Mr. Crippen. It is always good to have you here. I do check your Web site from time to time, and I am sorry I haven't checked it for the last month or so, but the first 2 months of the fiscal year, revenues were running ahead of last year by 7 percent. Are we roughly at that level today?

Mr. CRIPPEN. We are still above what we had projected at this point, but these early months are quite variable compared with some of the others. So it is clearly too soon to tell, but we are above, not below, what we had anticipated.

Mr. GUTKNECHT. Under your model—and I know everybody likes to look out 5 years and 10 years, and frankly, as the weatherman, they don't do a very good job predicting what is going to happen tomorrow let alone what is going to happen 5 years from now. This year what are you assuming for economic growth?

Mr. CRIPPEN. I believe it is 3.3 percent. I could check that for you.

Mr. GUTKNECHT. But that is—you are still being relatively conservative compared to what we are seeing?

Mr. CRIPPEN. Yes.

Mr. GUTKNECHT. I want to go back to another point, and this is as much a comment as a question in response to what some of my colleagues have said. I think we need to change the whole way we look at this, and our job as a budget committee, as far as I am concerned, is to bake the bread like the little red hen. We have got to create the surplus. I have said if we could simply do this, if we could limit the growth in total Federal spending to no more than the average growth in the average family budget—in other words, the Federal budget should grow no faster than the average family budget, and that is running a little over 3 percent right now, and I think actually next year we can do a little bit better than that. We can actually come in under that number. I believe if we do that, we are going to guarantee strong economic growth and significant surpluses as we go forward.

I want to go back to a point. When people say we can't limit the growth in Federal spending or we can't freeze Federal spending, we are going to have a meeting tomorrow, and I hope all of my colleagues will come and take a look at how much, as far as I am concerned, waste is still in this Federal budget.

Let me just throw out a couple of things. Last year we spent $1 billion on construction projects in Europe for the Army, the military, to defend Europe from whom? I mean, at some point we have to ask who are we defending Europe from? Last year we spent over $9 billion in the Balkans. Again, there was supposed to be burden-sharing between us and our allies. I haven't seen it.

We are currently, just in Medicare alone—let me just give you a few numbers, Mr. Crippen. We sometime have to start calculating this. Let us take one drug, Coumadin. If you buy it in the United States, the price is $35.25. If you buy that drug in Europe, it is $2.85. I can go on to a long list of what we pay for prescription drugs in the United States, and ultimately it costs the taxpayers—right now, back in the envelope calculations we could save $1.8 billion in Medicare alone, not even including what we pay through the VA for drugs, if we just simply could get somewhere close to the world price of prescription drugs.

Let me talk about some other areas where I think there is just enormous waste. As my colleague from Michigan said, the Education Department is a $38 billion company, which, for the second year in a row, our own General Accounting Office says their books are unauditable. At some point we on the Budget Committee have to demand some accountability.

I raised the issue last year when the representatives from the Pentagon were here, because I have heard this and it has yet to be refuted. We currently have more generals and admirals than we had at the peak of World War II when we had 16-1/2 million Americans in uniform. We have become so top-heavy, and yet we can't find any savings. In my opinion—and this report is filled with even more examples. The Pentagon is still spending, one example, $75.60 for set screws that American consumers would buy for 57 cents.

I mean, I think we on this committee have to take a very tough stand, and the argument that we can't balance the budget or we can't provide tax relief or we can't freeze spending, discretionary spending, I think, is outrageous, and I think when the American people begin to realize how much, whether it is the Pentagon, the Department of Education, do we need 6,000 people in the Department of Housing and Urban Development, I think that is a legitimate question, and somebody ought to be asking it, and I think it ought to be the members of this committee, because if we do, and if we get better answers and better accountability, I think we can balance the budget. I think we can save Social Security. I think we can pay down debt. And I think we can have tax relief that helps families keep more of what they earn.

That is an editorial statement, but, Mr. Chairman, I hope more of the Members will be here tomorrow to go through this report and just see how much waste and mismanagement is still embedded in this Federal budget, and I think once they do, they will come to the same conclusion. We can balance this budget, and we can freeze discretionary spending if we have the courage to say no to some of this waste.

I yield back my time.

Mr. GREEN. I think the session tomorrow will be very interesting.

Before we proceed, I would like to ask unanimous consent that any questions may be submitted for the record.

Mr. GREEN. And without objection, we will proceed on questions. Mr. Bentsen.

Mr. BENTSEN. Thank you Mr. Chairman.

Mr. Crippen, good to see you. I thought for a second my colleague from Maine, Mr. Allen, was my colleague from Minnesota, Mr. Minge, when he was talking about drug prices and whether or not we ought to impose some price controls, maybe some European Union-type model or something, but I won't go any further on that.

I want to reference my questions back on the discussion of what the baseline is and what our future fiscal policy should be because that is really what we are talking about. I would reference you back to last year's markup of the fiscal 2000 budget resolution, which ended up going nowhere. I am going to bring this up all year, but I did offer an amendment last year that would have frozen spending at the caps per the 1997 BBA and dedicated all surplus, on- and off-budget surplus, to debt retirement. That amendment was not unanimously, but almost unanimously, rejected by Republican and Democrat alike. So when my colleagues talk about us being able to do this, I would remind them that they were given an opportunity and failed.

CBO uses a criteria dealing with behavioral compliance in the Medicare baseline. In a second, I will talk about the Medicare baseline, but right now I want to talk further about the table that our Chairman put up there. If you were to apply that type of formula to congressional action in your budget projections and extrapolate what the trend has been for Congress over the previous 3 to 5 years in discretionary spending, what would your baseline look like, because according to your testimony it certainly wouldn't be a freeze. In some instances, it would certainly be somewhere at or above the rate of inflation, is that correct?

Mr. CRIPPEN. It depends on which 3 or 5 years you choose.

Mr. BENTSEN. Let's just talk about, say, fiscal 1995 through fiscal 1999.

Mr. CRIPPEN. Because spending in 1995 was lower, you probably have essentially a freeze since then.

Mr. BENTSEN. Nominal freeze?

Mr. CRIPPEN. Yes, nominal. This shows the sensitivity of what base you use. Because there was an absolute reduction in discretionary spending in 1995, by including that year you show that a freeze is possible. By leaving out 1995, you may suggest that a freeze is not possible, which belies the variability in the underlying——

Mr. BENTSEN. You said a nominal freeze. A nominal freeze assumes the rate of inflation.

Mr. CRIPPEN. No. Nominal without inflation.

Mr. BENTSEN. So it did assume the rate of inflation.

Mr. CRIPPEN. It did not.

Mr. BENTSEN. So are you talking about a real freeze.

Mr. CRIPPEN. Again, if you choose a different time period, you will get a different answer. The point I would like to make is simply that discretionary spending has gone up, and it has gone down. Over the past several years, it has gone up.

Mr. BENTSEN. But the valley was hit in 1995, and since then, we started to ramp back up, right?

Mr. CRIPPEN. Yes.

Mr. BENTSEN. So, if you looked at the behavioral experience of Congress on the discretionary side, then you would say it is less than likely that they are going to follow a real freeze in the future.

Now, through your testimony you show a rampdown, a dramatic rampdown in discretionary spending as a percentage of GDP from 1960 to today, dramatic rampdown certainly from 1980 to today, and a dramatic increase in mandatory spending. I would just note that for all that we hear about how government is strangling the American economy and how terrible things are as a result of it, it is ironic that you look and see how little discretionary spending is of the gross domestic product, particularly nondefense discretionary spending. I might add that it is hard to find the period of economic growth that compares to the current recovery cycle, certainly in the postwar period and even in the last century. So it certainly has not caused a recession or a depression or controlled growth to such an extent that it is killing the American economy. I think maybe we should also not just focus so much on what we would do on the discretionary side, because, as I see it, our experience on the discretionary side of trying to achieve a real freeze is not particularly good.

But in Medicare, as I read it, the Medicare baseline from 1997 to today has changed dramatically. Since the Balanced Budget Amendment in 1997, the baseline has decreased by about $100 billion over 5 years and is projected to decrease even more. First, I want to know how did CBO miss that reduction, because we relied upon you when we formulated the BBA in 1997?

Second, virtually all of us on this committee have heard from hospitals about the cuts, I probably have more hospitals than anybody else in a district. Last year we had the BBA give-back bill, and we put back about $15 billion over 5 years. What is to say that Congress won't at some point put back more of the BBA? There are about a dozen bills that have been filed, including bills from very influential committees. Should we not, when we look at these surplus figures, be taking a very hard look as to whether or not Congress may decide to go back to what the projected 1997 BBA baseline was for Medicare?

Mr. CRIPPEN. There are two questions here. One is, what happened to CBO's 1997 estimates? The second is, how much of that is factored in or should be factored in for the future? The 1997 estimates may well be accurate. That is to say, the change in policy that the BBA instituted may produce roughly the savings that we estimated at that time. Other things have changed as well since then, a principal change being what has happened with the initiatives by the administration to increase compliance with Medicare law and regulations.

As I mentioned earlier, we are getting some effects out of the compliance efforts that we did not expect in 1997 and that does not have anything to do with the BBA. So it is not just that the policy changed in 1997. There are other things that have happened that are causing Medicare to spend less than we projected in 1997. Home health care was mentioned earlier. The law that you passed limited the average payment per beneficiary under the interim payment system. What many home health providers did was cut off services to patients who reached the per-beneficiary limit, which lowered average payments below the allowable limit. So the implementation had a little different effect than anyone had anticipated.

The primary point, though, is that other things happened in addition to your policy changes. So it is not——

Mr. BENTSEN. But if we were to reverse the policy——

Mr. CRIPPEN. You would not get all of that spending back.

Mr. BENTSEN. Any we get back obviously is going to adjust the Medicare baseline, and it is going to take it out of the hide of the projected surplus. We should be cognizant of that, given our earlier actions.

Mr. CRIPPEN. Right.

Mr. BENTSEN. Thank you, Mr. Chairman.

Mr. GREEN. Ms. Hooley, questions.

Ms. HOOLEY. Yes. Thank you.

Thank you for coming today. I am looking forward to your coming in another month when you have actually finished your job.

Mr. CRIPPEN. So am I.

Ms. HOOLEY. I come from the State of Oregon, and I can remember in 1979 when we were going great guns in our economy, and all of a sudden without any warning in 1981 the bottom fell out of our economy, and we made huge cuts. It was a tough time in our State, and we spent about 6 years getting back on track. So I have—when I see huge new proposals that would really have huge impacts for future on the budget, I get very nervous about it, knowing how quickly your surplus can disappear.

And I think there is agreement in this group and with you that paying down the national debt should be a priority, and you talk about it would promote private investment and therefore increase our productivity and spur faster economic growth. I think the problem is just how much do we need to do to pay down that debt.

The President has proposed that we should use the bulk of the surplus to pay down the debt. Greenspan has argued, and you saw it up on the chart, that we need to pay down our debt. My question is do you agree that using the bulk of our surplus to pay down the debt should be our number one fiscal priority, and how much would you use?

Mr. CRIPPEN. Relative to your first question, as economists, we would say yes, we think paying down the debt will help economic growth and therefore long-term budgetary problems. I have no answer as to how much. If we look at Social Security, for example, or the Nation's long-term obligations, it is clear that even if we saved all the projected surpluses, they would not be enough to fulfill the obligations that we now have on the books to my generation. We are still going to be taking more out of the economy in 2030 than we are today for retirement and other programs for the elderly.

But that is not to say that you may not find priorities that are more important than economic growth. You may find other ways to grow the economy that have little to do with saving—with paying down the debt. This is not an absolute in which you can say saving $2 trillion is enough, or saving $3 trillion is more than enough. In some absolute sense, all of it is not enough. It depends on what your objective is.

Ms. HOOLEY. Your analysis concludes that if we maintain a zero real growth spending level over the next 10 years, that our on-budget surplus will be a little over $800 billion, right?

Mr. CRIPPEN. Right.

Ms. HOOLEY. If we adopted a zero growth spending on the discretionary budget, do you think we could continue to make substantial progress in paying down the national debt?

Mr. CRIPPEN. No matter which of these baseline variations you look at, by 2010, we will have something like $2.3 trillion in surpluses in Social Security alone. That means that if we do not cross this line we have established between on-budget and off-budget surpluses, we will have at least $2.3 trillion in debt paid down. Anything above that is obviously helpful as well. So no matter which of these variations you want to assume, you will have substantially paid down $3.6 trillion in debt, $2.3 trillion out of Social Security alone. I do not know if that has been responsive to your question.

Ms. HOOLEY. Representative Minge brought up looking at some of the States' programs and what they have done. We have a unique program in our State, and some people would think it is good, and some people not good, but it really depends on the projections, whether they come true and whether or not there is a refund or not a refund. And it is a way of—because of the uncertainty with any projection, it is a way of dealing with the budget, giving the money back to the people without changing your tax code. And again, I am going to recommend that you—that someone on your staff maybe look at some of those programs out there that States have been successful in doing that. Thanks.

Mr. GREEN. Mr. Gutknecht.

Mr. GUTKNECHT. Mr. Chairman, I want to come back to a point that was raised. I won't debate who has more hospitals in their district, I or Mr. Bentsen. My hospitals have been quite noisy regarding the Medicare cuts. And one of the questions I had for them was how much were you cut, and the answer I keep getting is, I don't know, but it was a lot.

So we went to the Health Care Finance Agency and said, well, how much in aggregate were hospitals cut? And their answer was something like, well, we don't think they were cut, that they actually got about a 6 to 6-1/2 percent increase. I said, well, just give me the numbers. They can't give me the numbers. They don't have the numbers.

Do you have the numbers? Can you help us get the numbers?

There was a debate that raged during the Middle Ages in terms of exactly how many teeth a mule had. Finally one bright young fellow said, let's open its mouth and count them. You know, it would be very helpful if we had an honest count here of how much we are actually—I understand there are some unintended consequences, and there are some things that have happened with the way the reimbursements are made and so forth, but at the end of the day it would be helpful if we at least knew how much hospitals were reimbursed in fiscal year 1999, how much they are being reimbursed in fiscal year 2000 and so forth. And I think you could be the person who helps us count those teeth.

Mr. CRIPPEN. We have thought some about this, as you might guess. Part of the problem is the data lags at the Health Care Financing Administration (HCFA). Traditionally, lags are 12 months or 18 months.

Mr. GUTKNECHT. I think you are being very generous. This is amazing to me that an agency that is responsible for paying bills, I mean, that is basically what they do, and yet they don't have data for up to 18 months after the checks have been issued. Now, I would not invest in a bank that did business that way.

I am sorry, that is an editorial.

Mr. CRIPPEN. We rely on other agencies to develop that kind of data—we do not develop data on our own. In terms of HCFA, we can do nothing until they produce the numbers, but we have talked to our sister agency, the General Accounting Office (GAO), for example, which has studies under way and has actually gone into the field. The question we need to ask is not only how much has been cut but what effect that has had on beneficiaries. That is the important question—whether beneficiaries are receiving the services they need.

GAO has been checking on that, but I do not know the status of their research. We are kind of stumped. We think about these problems, but we have no answers for you.

Mr. BENTSEN. Would the gentleman yield on that point?

Your hospitals may want to talk to my hospitals, because my hospitals certainly know how much is in their budget projections, what the reductions mean, and the PPS update and the other reimbursements they get. And the impact is on that there are other costs arising, their census of patients is rising, and so against that they do feel a cut. And particularly for those hospitals which I know——

Mr. GUTKNECHT. Is it 3 percent? Is it 4 percent? Is it 6 percent? Is it 10 percent?

Mr. BENTSEN. CFO should be able to provide you with information. In dollar terms of what the impact is when they project what their Medicare receipts will be on a per-patient basis against what they perceive to be their per-patient cost.

Mr. GUTKNECHT. At this point I haven't been able to get very good information from anybody, and they are all talking about the cuts, and they are saying it is devastating them. As a member of the Budget Committee, I think we do want to try and rectify that, but it is really difficult to get our arms around it if neither they, nor you, nor the Health Care Finance Agency can give us some numbers. Right now we have no numbers to work with.

Mr. GREEN. Since we allowed questions to be submitted for the record, I would be interested to see Mr. Crippen's response to the number of teeth in a mule.

Next, Mr. Markey?

Mr. MARKEY. I thank you very much, Mr. Chairman. And like that medieval theological debate, we have similar problems here today because everyone can see what they want to see. You can see a lower, a midcourse, or a higher surplus over the next 10 years, depending on which way you want to turn the image. You can see whatever you want to see. It is beautiful because each one of us can then project our own theological beliefs, politically speaking, into this surplus projection. But I know, as does the gentleman from Texas, that when three hospitals close in your district in the 2 years after the Balanced Budget Act amendment is passed in 1997, that you don't have to be a mining expert to know that the canary died in the mine shaft. There is something wrong down there. There just isn't enough air to breathe.

So we have got a problem at the local level. And again, I believe, as you know, this committee has the highest prevarication coefficient of any committee in Congress. The hardest thing to get numbers out of is CBO or even OMB back in 1997, because if we were able to open up the mule's mouth back then, we would have known that the budget was already balancing itself by the end of 1997, but, of course, they were told by this committee and by the administration not to give any new numbers while we were anticipating the vote at the end of July on the Balanced Budget Amendment in 1997. So we didn't have the updated numbers at that point in time which would have revealed that this miraculous balanced budget that was the target for the year 2002 was reached in 1998.

Isn't that great, just by a single vote in 1997. We did the whole thing in that year and started to see the projections. That is because the mule didn't open his mouth. It was under orders from both OMB and CBO. So that is a problem. These people just take orders, so it is just the way it is.

So I am going to get away from that because that gets theological.

What I would like to do is to deal with the issues on Social Security. Again, it gets kind of hard to solve the problem for 7 years, kind of gets outside people's grasp, but Mr. Bartlett, Roscoe Bartlett, zero ADA rating, and Ed Markey, 100 percent ADA, kind of joined together in a very simple plan which we think makes some sense, and I would like to get your views on it. What it does is it permits a portion of the Trust Fund to be invested each year in securities. It is no geniuses need apply. Investments will be under index funds only to mirror the long-term growth of the market as a whole, and additional political insulation would be provided by requiring proxies to be voted to mirror the voting by nongovernment investors. And we would have multiple 10, 20 mutual funds or other financial institutions each taking a relatively small percentage of the money so that no one investment firm would have the control over that large sum of money.

What do you think about that as an idea, Mr. Crippen? Do you think that would help to advance the solvency of the Social Security Fund?

Mr. CRIPPEN. The answer depends critically on exactly how you just asked the question. Your idea could certainly raise the rate of return and make the Trust Funds look better. The ultimate question, though, is, does the investment increase national savings and therefore help economic growth? Because ultimately, the controlling factor is the size of the economy, not the balances in the Trust Funds.

For example, you have a choice today. You could pay down debt with, say, some of the Social Security surpluses now, or you could buy equity securities. The two strategies would have the same effect essentially on national savings, so that would not change the outlook for the economy. So if your plan would increase——

Mr. MARKEY. Do you think this plan would? The gridlock is that a lot of the Republicans want to give the money to individuals, and they would invest, and a lot of Democrats don't want to give it to anybody, even index funds. So we are trying to go up the middle here.

Let's just compare what we are doing here with IRAs, with individual accounts that the Republicans want. Would there be a difference in terms of the impact it would have on savings if it was done this way as opposed through individuals?

Mr. CRIPPEN. Probably not, but it depends critically on——

Mr. MARKEY. If we could create similar incentives in both programs, you would still remain agnostic in terms of whether or not it would enhance the savings?

Mr. CRIPPEN. I would.

Mr. MARKEY. So a lot of this discussion gets to that pivotal first question, and you are not sure that anything we would do——

Mr. CRIPPEN. Very clearly, paying down debt held by the public would enhance net national savings.

Mr. MARKEY. I'm talking about going to individual accounts——

Mr. CRIPPEN. It depends on how you do it. There are many plans—yours may be included—that would actually enhance national savings and therefore help economic growth. What I am trying to emphasize is that the balances in the Trust Funds have little to do with our ability to pay for the obligations we have.

Mr. MARKEY. If I gave you my plan, would you give me a written response as to whether or not you think that that would enhance national savings?

Mr. CRIPPEN. I will be happy to.

Mr. MARKEY. And contrast it with whether or not the Republican plan that gives individuals the ability to take their own——

Mr. CRIPPEN. Which Republican plan?

Mr. MARKEY. The one that Dennis Hastert would split. How is that? So we would take that. But just so—I just want to break this cycle here. We have got to move to this marketplace, and I think that the biggest obstacle that we have is that neither side wants to give up either doing nothing or going all the way like individuals do it. I don't think either one of them is realistic. I think we have got to get our foot in the water here. We have got to get people used to it. If this is a way that enhances the savings goal and yet gets us to get the benefit of the stock market long term, then it would be a good way of going.

So I would appreciate it if you would give me a written response. We will give you the details of the plan, and if you tell us that it enhances national savings, then we would, I think, be able to build a broader coalition this year toward advancing that goal.

Thank you, Mr. Chairman.

Mr. GREEN. Thank you, Mr. Markey.

Mr. Crippen, earlier when you were responding to a question from Mr. Bentsen, I was intrigued by how you pointed out that discrepancies in forecasts have been less due to based on calculations and more on other side events that have changed, the eddies and currents have changed. As we go forward, as you know, we will be looking at a variety of tax relief plans. In your view, what kind of tax relief plans would project or would create greater economic growth and would create a positive push on the surplus as opposed to a cost, which some have suggested?

Mr. CRIPPEN. Let me answer you in two ways. First, if you, for example, sent us a tax cut and asked not only what the revenue effects would be—which the Joint Committee on Taxation provides—but also what would be the economic effects, we would say, we do not know. Currently, when we prepare estimates, we do not also assess the impact of the proposal on the economy or on economic growth. We may do that someday, but we are not currently doing it.

Second, what I can say in answer to your question is not our view because CBO does not have an opinion on this matter. There is a pretty extensive literature that suggests that changing incentives in the Tax Code for savings or for work—changing marginal tax rates, for example—is the kind of things that is more likely to increase output, work, and economic growth. But beyond that, there is not much the literature—the empirical literature, in particular—can tell you about whether one kind of tax cut is better than another.

Mr. GREEN. Well, for example, a—the marriage penalty reduction that we just passed, what is your view as to the incentives changed by that?

Mr. CRIPPEN. Again, CBO has no view. Probably, the view of the economics profession would be that the change in the marriage penalty will have relatively little effect on economic growth. The effect on incentives to work or to save would be limited because so much of the tax savings from the cut would not affect taxpayers at the margin.

Mr. GREEN. What about the type of State tax reduction that we saw in last year's tax bill that was passed? What is your view as to the economic impacts from that?

Mr. CRIPPEN. Again, CBO does not have a view. I think the literature is mixed on the question but mostly suggests that there is not much impact. I would have to check that, however. The last time I looked, there was not much effect on economic growth.

Mr. GREEN. Are there other questions? Ms. Hooley, do you have any further questions?

Ms. HOOLEY. No.

Mr. GREEN. Seeing no other questions, again, Mr. Crippen, we thank you very much.

Mr. CRIPPEN. Thank you.

[Whereupon, at 12:30 p.m., the committee was adjourned.]

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