PERSPECTIVES ON RENEWING STATUTORY PAYGO

HEARING

BEFORE THE

COMMITTEE ON THE BUDGET
HOUSE OF REPRESENTATIVES

ONE HUNDRED TENTH CONGRESS

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PERSPECTIVES ON RENEWING STATUTORY PAYGO

WEDNESDAY, JULY 25, 2007

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

The Committee met, pursuant to call, at 10:00 a.m., in room 210, Cannon House Office Building, Hon. John M. Spratt, Jr. [Chairman of the committee] presiding.

Present: Representatives Spratt, Edwards, Cooper, Schwartz, Kaptur, Becerra, Doggett, Blumenauer, Berry, Boyd, Sutton, Etheridge, Baird, Bishop, Ryan, Barrett, Bonner, Garrett, Conaway, Campbell, Tiberi, Porter, Alexander, and Smith.

Chairman SPRATT. Because we have got several witnesses and several members who need to leave around ten-thirty to eleven o'clock and the sooner we get going, the more we will be able to cover this morning.

This morning's hearing is about perspectives on renewing statutory PAYGO and we have a most distinguished set of witnesses. Our first panel consists of Peter Orszag, Director of Congressional Budget Office, and David Walker who is the Comptroller General.

Our second panel consists of Bob Bixby, Executive Director of the Concord Coalition; Bob Greenstein, Executive Director of the Center on Budget and Policy Priorities; Maya MacGuineas, President of the Committee for a Responsible Federal Budget; and our former colleague, Pat Toomey, President and CEO of the Club for Growth.

Ever since its enactment in 1990, we have been supporters on our side of statutory PAYGO and since its expiration in 2002, we have been committed to renewing it. Quite simply, the record shows that it works.

When statutory PAYGO was on the books in the 1990s, it helped us convert chronic deficits into record surpluses. But after it was allowed to expire in 2002 and large tax cuts and offsets were passed along with large increases in mandatory spending such as for prescriptions, record budget deficits returned.

At the beginning of this Congress, one of the first steps we took was to make PAYGO part of the House rules, a step we could take immediately because it did not require negotiation with the Senate or approval by the President.

The House PAYGO rule requires that every bill affecting mandatory spending or revenues be deficit neutral. This rule has been in force consistently and followed since its adoption in January despite predictions when it passed that the House would honor it in the breach.

The budget conference report for 2008 adopted this spring established a similar PAYGO rule in the Senate and expressed the sense of Congress that the statutory version of PAYGO be renewed as an additional measure, a backup measure, if you will, for fiscal discipline.

At least one bill extending statutory PAYGO has been introduced in this Congress, H.R. 2685, introduced by Mr. Hill and cosponsored by Budget Committee members Mr. Berry, Mr. Boyd, Mr. Cooper, and Mr. Moore.

Before turning to our witnesses for testimony, I want to turn to our Ranking Member, Mr. Ryan, for his opening statement.

Mr. Ryan.

Mr. RYAN. Thank you, Chairman, and welcome the gentlemen here today. It is nice to have you guys with us again.

The concept of PAYGO seems like an enforcement tool that no one could object to. As the proponents put it, it simply says that any new spending Congress adopts has to be paid for. That sounds reasonable enough. But as is true with a lot of things, this subject is a little more complicated than it first might appear.

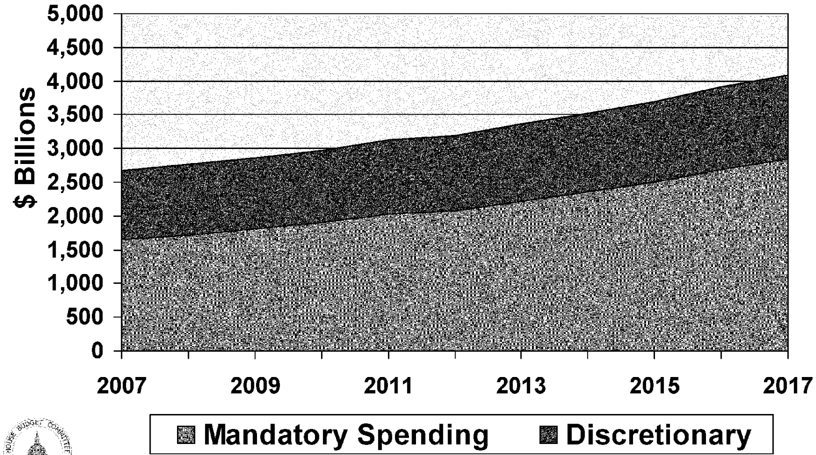
I have made no secret of my concerns with the PAYGO rule adopted by the House this year and I will note those concerns again right here.

This year, the Majority passed its version of PAYGO ostensibly as a key means for Congress to control the budget. Shortly after that, this Committee began to hold hearings, most of which focused on the largest economic and budgetary problems that Congress faces, and that PAYGO does not touch the project growth of entitlement spending under current law.

We have two of the nation's foremost experts on that topic sitting right before us today. As both of our expert witnesses today have repeatedly warned, the current rate of entitlement spending is already out of control. It cannot be sustained either by the budget or by the economy.

If you could pull up chart one, please.

PAYGO WILL NOT CONTROL BASELINE SPENDING



Source: CBO March Baseline

You can see from this chart there in the green the currently projected growth of entitlements. PAYGO does not even apply to any of that. It applies only to new legislation and new spending increases. It does not touch the underlying problem. Only real fundamental reform can do that.

PAYGO was never meant to be a substitute for real budget and policy decisions. And in that regard, the Majority's budget this year is a real disappointment. It does nothing to address this massive entitlement growth, but even worse, it makes $190 billion worth of new spending promises in what the budget calls reserve funds without any offsets identified. That is not budgeting. That is relying on somebody else to budget. And in all likelihood, that someone else is going to be the taxpayers.

Also, this year is the first time Congress has adopted PAYGO without also adopting caps on appropriations. Appropriations still make up a large part of the budget, about a third. And as you can see from the chart and if the Majority is serious about spending control, it has got to look at ways to control all of Congress' spending. The blue part is the discretionary side.

That said, I will be the first to admit that we Republicans have not always been on the side of the budget angels either. We, too, spent more than we should have. And I want to be clear about that, but we also made efforts to correct that. We put tight limits on nonsecurity appropriations and we took the first steps to reform our massive entitlement programs, saving $40 billion for taxpayers in the process.

We managed to do those two things even though there was no PAYGO and no discretionary caps. We just made the tough choices and passed the necessary measures.

Finally, no budget enforcement rule or law can work if Congress does not take it seriously. And there are certain indications that

that is the case with PAYGO. We have seen evidence of this in the Education Bill which claimed that Congress would cut student loan interest rates in half over the next five years, then in year six, suddenly raise them right back up to the current level, clearly a gimmick to make the bill appear to comply with PAYGO.

The SCHIP Bill that the Senate just passed employed a similar gimmick intended to mask the true cost of the bill and circumvent the PAYGO rules to the tune of $40 billion according to the CBO. But since the Farm Bill is slated for the floor this week, let us use that as an example of how PAYGO is working so far.

And if you could bring up chart number two, I would appreciate that.

PAYGO DODGE FOR FARM BILL

(H.R. 2419 As Reported)

	10yrs
Gross Cost	14.2B
"Real" Spending Cuts	- 8.5B
Phony Timing Shifts	- 4.7B
Non-Scoreable Offsets	- 0.4B
Actual Costs	5.7B

This chart summarizes just the Farm Bill as reported by the Agriculture Committee. It is a gross cost, a gross spending increase of 14.2 billion over ten years. Now, let us look at how this spending increase is supposedly paid for.

First, there is $8.5 billion in real spending cuts. These are legitimate and CBO has scored them as legitimate savings. Then there are $4.7 billion worth of timing shifts. These are quote, unquote savings the Agriculture Committee claims from delaying direct payments, counter cyclical payments, and payment to crop insurers, and making early collections of crop insurance premiums.

But even as the Director of CBO has written, quote, all of those outlays will ultimately occur in subsequent years, end quote. In other words, they are not real savings.

Third, the bill as reported takes credit for about 400 million in savings from provisions aimed at detecting fraudulent payments. But under CBO's usual guidelines, these savings would not be counted, but CBO says in its cost estimate for the bill that it was directed to give the Agriculture Committee credit for them.

So the bottom line is that if you give the Agriculture Committee credit only for the legitimate spending cuts and not for the timing shifts or the nonscoreable offsets, their bill still increases spending by $5.7 billion over ten years. But, again, this is just for the bill as reported.

We keep hearing that the Majority also plans to double the spending increases in the bill and turn to other committees to find offsets for additional increases. We do not know for sure what those offsets are or where they are coming from. Are they tax increases or fees or what? More importantly, are they real? All this makes me wonder how serious we all are about the PAYGO commitment.

Now, having said all this, I should also add that I have long supported process reforms and many of us here at this table have worked at that to make the budget more transparent and accountable. I believe that process can be used to create incentives for controlling spending and I believe we can do this on a bipartisan basis.

I think the Majority has made good strides on earmark reform in the beginning of the year. Went backwards a little bit on that, but I think after we had some episodes on the floor, the Majority has come back to making the earmark reform transparent.

Also, there are a lot of ideas we have had before that were bipartisan. The line item veto passed out of this Committee with a bipartisan vote last year passes on the floor with a big bipartisan vote, yet we seem to be having a hard time getting it scheduled for a hearing, a markup, or even floor consideration.

The Blue Dogs have given us good ideas. They have given us a lot of good ideas that many Republicans agreed to. These include setting aside funds for emergencies which we did in the last Congress which was eliminated in this Congress. We have had votes here in this Committee on our markup of the budget resolution trying to incorporate some of the good Blue Dogs' ideas that were offered in the last Congresses only to see them shut down.

So my appeal here is let us get back to working together to bring real reform to the budget process so we can do this on a bipartisan basis. The only way we are ever going to get the budget under control is to stop pretending that there is an easy, magic fix out there and to get down to actually doing the work that we know must be done. And I certainly hope Congress achieves that realization sooner rather than later.

And I thank the Chairman for his long indulgence.

Chairman SPRATT. Thank you, Mr. Ryan.

In the interest of time and proceeding with our witnesses, let us go straight to Dr. Orszag.

Dr. Orszag, I believe we have your testimony and we will simply make your testimony and David Walker's testimony part of the record so that each of you can summarize your statement as you see fit. But the floor is yours.

STATEMENTS OF PETER ORSZAG, DIRECTOR, CONGRESSIONAL BUDGET OFFICE; DAVID M. WALKER, COMPTROLLER GENERAL OF THE UNITED STATES

STATEMENT OF PETER ORSZAG

Mr. ORSZAG. Thank you very much, Mr. Chairman, Congressman Ryan, members of the Committee. Thank you for the opportunity to testify this morning.

In my oral remarks, I would like to highlight four points. First, the BEA, that is the Budget Enforcement Act's PAYGO requirement helped to enforce multi-year fiscal goals and prevent fiscal deterioration during much of the time it was in effect. When the budgetary situation and policy priorities changed, however, the PAYGO requirement and discretionary spending caps were often superseded or ignored.

Part of PAYGO's influence, moreover, may be more apparent than real in that any set of rules tends to encourage efforts to design policy changes in a manner that meets only the strict letter of the requirement. The bottom line is that rules can definitely help to enforce fiscal discipline and CBO believes that they did do so in the 1990s, but they are not a panacea.

Second, even if PAYGO rules were fully successful in achieving their objective, that is offsetting the budgetary impact of policy changes, they would succeed only in preventing further deterioration of the long-term fiscal imbalance that exists under current policies. The nation faces a very substantial long-term fiscal challenge under those sets of policies and PAYGO rules do not address that underlying problem.

This chart which I have shown you before and I will continue to show you at every opportunity highlights the basic problem. If healthcare costs continue to grow at the same rate over the next four decades as they did over the past four decades, Medicare and Medicaid will grow from four and a half percent of the economy today to 20 percent of the economy by 2050. That is the entire size of the federal government today.

There are significant opportunities to constrain healthcare costs over the long term without harming health and that is the central long-term fiscal challenge facing the United States.

These crucial fiscal issues are not directly addressed by PAYGO rules and indeed many steps that hold the potential to reduce spending over the long term, for example, investing in comparative effectiveness research to examine what works and what does not in healthcare, actually entails short-term costs that would need to be offset under the PAYGO rules.

Third, both the House and Senate already have nonstatutory PAYGO rules in place. One striking way in which the House rules differ from the previous statutory PAYGO requirement and from the Senate rule is that it applies to each separate House bill rather than to a broader collection of legislative proposals. Consequently, it does not allow savings from prior bills to cover the cost of a pending bill.

Relative to the current rules in the House and the Senate, reinstating a statutory PAYGO requirement might provide a more permanent structure and would make possible enforcement mechanisms like sequestration that cannot be established under House and Senate rules.

Finally, policy makers may also want to consider how budget rules affect the long-term budget picture. Even within the BEA PAYGO structure, only medium-term effects on the budget were captured and the long-term effects were sometimes quite different.

Revisiting the issue of a statutory PAYGO requirement might provide an opportunity to consider rules governing long-term budgetary effects such as the one currently embodied in the Senate PAYGO rule.

On that note, I wanted to let the Committee know that CBO will be devoting increasing resources to such long-term budget effects, especially in the critical area of healthcare.

Later this year, we will be releasing an updated long-term budget outlook and we intend to release a long-term budget outlook on an annual basis thereafter to provide this Committee and the rest of the Congress with the information that you need to tackle these long-term budget challenges.

Thank you very much, Mr. Chairman.

[The prepared statement of Peter Orszag follows:]

CBO TESTIMONY

Statement of
Peter R. Orszag
Director

Issues in Reinstating a Statutory Pay-As-You-Go Requirement

before the
Committee on the Budget
U.S. House of Representatives

July 25, 2007

This document is embargoed until it is delivered at 10:00 a.m. (EDT) on Wednesday, July 25, 2007. The contents may not be published, transmitted, or otherwise communicated by any print, broadcast, or electronic media before that time.

CONGRESSIONAL BUDGET OFFICE
SECOND AND D STREETS, S.W.
WASHINGTON, D.C. 20515

Chairman Spratt, Congressman Ryan, and Members of the Committee, thank you for the opportunity to testify on the pay-as-you-go (PAYGO) requirement under the Budget Enforcement Act of 1990 (BEA) and on the issues associated with its possible reinstatement.[1]

The principal enforcement procedures set in place by the BEA—the annual limits on discretionary spending and the PAYGO requirement for new mandatory spending and revenue laws—expired at the end of fiscal year 2002. Those procedures governed federal budgeting for more than a decade and contributed to the improvement in the fiscal balance during the 1990s. The lessons of that experience may be helpful in considering whether the statutory PAYGO requirement should be reinstated.

My testimony makes the following general points:

- The BEA's PAYGO requirement, as well as the law's discretionary spending limits, helped to enforce multiyear fiscal goals and prevent fiscal deterioration. When the budgetary situation and policy priorities changed, however, the PAYGO requirement and discretionary spending caps were often superseded or ignored. PAYGO rules probably influence fiscal outcomes, but that influence may be stronger in some circumstances than others.

- Although PAYGO may help to prevent a deterioration in the fiscal picture, it only applies to new policy changes rather than the effects of existing policy. Consequently, PAYGO by itself does not address the nation's long-term fiscal imbalance, which is driven mostly by growth in the cost of health care.

- Any PAYGO system requires a set of scoring rules, concepts, and baseline requirements. One key question is whether a statutory PAYGO requirement should apply to both mandatory spending and revenue legislation. If the primary objective of a PAYGO requirement is to avoid deterioration in the fiscal outlook, no differential treatment between mandatory spending and revenue changes would seem to be warranted. Including changes in revenue legislation within the PAYGO requirement, however, might impede other policy objectives.

- A related issue involves the treatment of expiring spending and revenue provisions. Some observers have expressed concerns that the current differences in rules governing expiring spending programs and taxes make it easier to extend spending programs than to renew expiring tax provisions. The existing approach generally ensures that the cost of extending a temporary policy past its initial expiration manifests itself either when the policy is initially adopted or when it is extended. That objective is crucial to the integrity of the process but can be achieved in a variety of ways.

1. Title XIII of Public Law (P.L.) 101-508, 104 Stat. 1388-573.

- Both the House and the Senate already have nonstatutory PAYGO rules in place. Those rules generally are enforced against individual bills or amendments as they are considered. A different approach to PAYGO could provide a mechanism for enforcing overall budget totals at the end of the Congressional session. A statutory PAYGO requirement could establish additional enforcement mechanisms, like sequestration, that cannot be embodied in House or Senate rules.

Overview of the Budget Enforcement Act

The Budget Enforcement Act of 1990 was built on an existing framework of budget enforcement procedures put in place by the Balanced Budget and Emergency Deficit Control Act of 1985 (initially known as Gramm-Rudman-Hollings).[2] The Deficit Control Act established a schedule of fixed, declining deficit targets leading to a target of zero in 1991. It also created the procedure of sequestration to automatically cut spending for many federal programs if the deficit for a fiscal year was estimated to exceed the target level.

Although deficits declined somewhat in the late 1980s, they failed to meet the statutory targets—in some years by substantial margins.[3] The Deficit Control Act's fixed deficit targets, even when revised, turned out to be unrealistic in light of worsening economic conditions and other factors.

In the fall of 1990, lawmakers enacted the Budget Enforcement Act largely as an amendment to the Deficit Control Act. The BEA was part of a multiyear agreement to reduce deficits that was embodied in the Omnibus Budget Reconciliation Act of 1990. The BEA represented a different philosophy of deficit control. With the BEA, lawmakers enacted rules that would constrain increases in the deficit resulting from new legislation but would allow for the budgetary effects of economic and technical factors outside of their immediate control.

The BEA established a budget enforcement framework that divided the budget into two parts. Discretionary spending, which is controlled by annual appropriation acts, would be subject to aggregate limits on budget authority and outlays. New laws affecting mandatory spending and revenues would be covered by a PAYGO procedure to prevent those laws from increasing the deficit. A breach of the discretionary spending caps would lead to reductions only in discretionary programs, and a breach of the PAYGO control would trigger cuts only in certain mandatory programs.

Originally set to expire at the end of fiscal year 1995, the discretionary spending limits and PAYGO requirement were amended and extended twice, in 1993 and

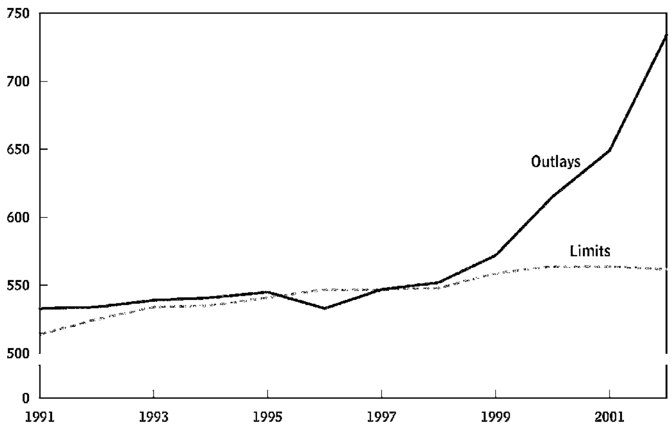
2. P.L. 99-177, 99 Stat. 1037.

3. See Congressional Budget Office, *The Budget and Economic Outlook: Fiscal Years 2004–2013* (January 2003), Appendix A, Table A-1, p. 111.

Figure 1.

Actual Discretionary Outlays Compared with Spending Limits as the Legislation Was Originally Enacted

(Billions of dollars)



Source: Congressional Budget Office.

again in 1997, as a part of two subsequent multiyear budget agreements. In each extension, the basic framework of the BEA was continued without substantive changes.

The nation's fiscal outlook improved significantly during most of the 12-year period that the BEA procedures were in place. Deficits declined steadily after 1992, and beginning in 1998, surpluses were recorded each year through 2001. Although most of the improvement in the fiscal picture over that period probably was not the direct result of the BEA framework, that framework did contribute to the improvement, if only by discouraging the adoption of policies that would have worsened the fiscal outlook. As surpluses began to emerge in the unified budget, the effectiveness of the BEA procedures eroded. From 1999 to 2002, annual appropriations exceeded the discretionary caps on new budget authority and outlays set in 1997 (see Figure 1). Over the same period, new laws affecting direct spending and revenues were enacted with significant costs but without offsetting savings (see Table 1). Despite those trends, surpluses continued to accumulate because of a surge in tax revenues. In 2001, however, the economy slowed significantly. The budgetary impact of that slowdown and the effects of enacted legislation brought back a deficit in 2002, just as the BEA procedures were set to expire.

Table 1.

Estimated Effect on the Deficit or Surplus of Selected Major Direct Spending and Revenue Legislation Enacted Before the Expiration of the Statutory Pay-As-You-Go Requirement

(Billions of dollars)

	1999	2000	2001	2002	2003	2004	2005	2006
Taxpayer Refund and Relief Act of 1999	0	-5.2	-1.0	-34.5	-52.8	-61.6		
Medicare, Medicaid, and SCHIP Balanced Budget Refinement Act of 1999	0	-1.2	-5.8	-4.2	-2.9	-2.0		
Ticket to Work and Work Incentives Improvement Act of 1999	0	0.1	-2.9	-8.1	-2.4	-2.2		
Agricultural Risk Protection Act of 2000	-5.5	-2.2	-1.6	-1.6	-1.7	-1.8		
Floyd D. Spence National Defense Authorization Act for Fiscal Year 2001		0	*	-0.4	-6.2	-6.6	-7.1	
Consolidated Appropriations Act, 2001[a]		0	-4.6	-8.7	-5.4	-4.2	-4.1	
Economic Growth and Tax Relief Reconciliation Act of 2001			-73.8	-37.6	-90.3	-107.4	-107.1	-134.9
Air Transportation Safety and System Stabilization Act			-3.7	-2.8	-3.9	-2.4	-0.8	0
Investor and Capital Markets Fee Relief Act				-1.3	-1.8	-2.0	-2.2	-2.3
Job Creation and Worker Assistance Act of 2002				-50.9	-42.9	-29.1	-3.6	16.1
Farm Security and Rural Investment Act of 2002				-1.6	-8.4	-9.9	-10.2	-9.9

Source: Congressional Budget Office.

Notes: SCHIP = State Children's Health Insurance Program; * = between -$500 million and zero.

Scoring for direct spending and revenue legislation is shown for the current year and the five years thereafter (or through 2006, when the PAYGO requirement was scheduled to expire).

Negative numbers indicate an increase in the deficit or a reduction in the surplus. Positive numbers indicate a decrease in the deficit or an increase in the surplus.

a. The Consolidated Appropriations Act enacted by reference provisions of nine bills, including the Medicare, Medicaid, and SCHIP Benefits Improvement and Protection Act of 2000 and the Community Renewal and Tax Relief Act of 2000.

Enforcing the PAYGO Requirement Through Sequestration

The PAYGO requirement generally stipulated that new mandatory spending or revenue laws enacted through fiscal year 2002 be "budget neutral" (that is, they must not increase the deficit or reduce the surplus).[4] The Office of Management and Budget (OMB) and the Congressional Budget Office (CBO) recorded the five-year budgetary effects of mandatory spending and revenue laws on a rolling PAYGO scorecard. At the end of a Congressional session, OMB totaled the budgetary effects of laws enacted to date for each year covered by the PAYGO scorecard. If new mandatory spending or revenue laws enacted during that session (when combined with any existing balances for the year already recorded on the PAYGO scorecard) caused an increase in the deficit or decrease in the surplus for the current year, a PAYGO sequestration—an automatic reduction in mandatory spending carried out by Presidential order—was required to offset the increase in the deficit or decrease in the surplus for that year. However, most mandatory spending was exempt by law from a PAYGO sequestration, and during the 12 years that the PAYGO requirement was in effect, a sequestration of mandatory spending was never ordered.

The statutory PAYGO requirement established by the Budget Enforcement Act differs from the House and Senate PAYGO rules now in effect. The statutory PAYGO requirement was enforced by sequestration after legislation was enacted instead of by a point of order while legislation is being considered.[5] Under the current House and Senate rules, each chamber is prohibited from considering revenue or direct spending legislation that increases a deficit (or reduces a surplus) over 6-year and 11-year periods, respectively, beginning with the current fiscal year. The statutory PAYGO requirement also adopted a multiyear approach to enforcement, but it used a rolling five-year scorecard.

4. Section 252 of the Deficit Control Act (the PAYGO requirement) did not expire at the end of 2002. Rather, it states explicitly that laws enacted after fiscal year 2002 shall not be subject to the PAYGO requirement. For laws enacted through fiscal year 2002, the PAYGO enforcement mechanism—a sequestration for covered mandatory programs—remained in effect through fiscal year 2006. However, legislation enacted in December 2002 eliminated the possibility of a sequestration of mandatory spending for those later years. See an act to reduce preexisting PAYGO balances, and for other purposes, P.L. 107-312, 116 Stat. 2456.

5. The House's PAYGO rule was adopted on January 5, 2007, as part of H. Res. 6. The current form of the Senate's PAYGO rule was adopted in May 2007 as part of the fiscal year 2008 budget resolution (section 201 of S. Con. Res. 21). The Senate's PAYGO rule originated in a budget resolution in 1993 and was modified and extended by subsequent budget resolutions and one Senate resolution.

Evaluating the PAYGO Requirement

Through the mid-1990s, the BEA appeared to contribute to the improvement in the fiscal outlook. Between 1991 and 1997, most new revenue and mandatory spending laws that were enacted were consistent with the PAYGO requirement to be budget neutral; end-of-session balances on the PAYGO scorecard consistently showed zero or net reductions in the deficit.

In 1997, lawmakers extended both the discretionary spending limits and the PAYGO provisions of the BEA as part of an agreement to eliminate the deficit by 2002. That goal was unexpectedly reached in the very next year, as the government recorded its first surplus in nearly 30 years. In that new fiscal landscape, with projections showing mounting surpluses for the coming decade, the BEA's restraints came under significant pressure. Lawmakers subsequently enacted legislation to increase mandatory spending or reduce revenues but used legislative directives to waive the PAYGO requirement. For 2001 and later years, lawmakers eliminated more than $700 billion in positive balances—that is, amounts that would have triggered a PAYGO sequestration—from the scorecard (see Table 2). Most of that amount stemmed from the estimated decline in revenues attributed to the Economic Growth and Tax Relief Reconciliation Act of 2001. By contrast, during the earlier years of the BEA, the balances on the scorecard were zero or negative, and lawmakers statutorily removed negative balances so that those savings could not be used to offset the costs of new mandatory spending or revenue legislation.

Evaluating the effectiveness of the sequestration mechanism in enforcing the PAYGO requirement is complex. Even though sequestration of mandatory programs was never ordered under the PAYGO requirement, the enforcement mechanism was not necessarily ineffective, because the threat of sequestration may, at various times, have served as a deterrent to legislation that would have violated the PAYGO requirement. In other years, lawmakers enacted such legislation but took steps to prevent sequestration. Those situations may have reflected a lack of consensus among lawmakers regarding the importance of fiscal discipline when budget surpluses were projected and when lawmakers pursued other priorities (including the war on terrorism).

In the end, rules such as the PAYGO requirement probably exert an influence, and possibly an important one, on budgetary outcomes. However, part of that influence may be more apparent than real, in that any set of rules may engender efforts to design policy changes in a manner that meets only the strict letter of the requirement. In addition, any set of rules tends to become less effective (or perhaps not effective at all) when the underlying objective no longer has support among policymakers.

Table 2.

Balances Eliminated by Law from the Pay-As-You-Go Scorecard

	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	Total, 1997-2006
Eliminated Balance	-9	-3	0	-3	90	65	127	150	142	144	701

Source: Congressional Budget Office using data from the Office of Management and Budget's final sequestration reports for fiscal years 1991 to 2003.

Note: Positive numbers indicate an increase in the deficit or a reduction in the surplus; that is, eliminating positive balances removed the need for a PAYGO sequestration. Negative numbers indicate a decrease in the deficit or an increase in the surplus; that is, eliminating such balances made them unavailable to be used as an offset to additional mandatory spending or revenue reductions.

PAYGO Does Not Address Underlying Fiscal Imbalance

Even if PAYGO rules were fully effective in achieving their objective—offsetting the budgetary impact of policy changes—they would succeed only in preventing further deterioration of the long-term fiscal imbalance that exists under current policies. The nation faces a substantial long-term budget challenge even if no further policies were adopted that would expand future budget deficits, and PAYGO rules do not address that underlying fiscal problem.

In particular, the nation's long-term fiscal balance will be determined primarily by the future rate of health care cost growth.[6] Over the past four decades, Medicare's and Medicaid's costs per beneficiary have increased about 2.5 percentage points faster per year than has per capita gross domestic product (GDP).[7] Under a simple extrapolation in which those costs continued growing at the same rate over the next four decades, federal spending on those two programs alone would rise from 4.5 percent of GDP today to about 20 percent by 2050 (see Figure 2); that amount would represent roughly the same share of the economy as the entire federal budget does today. If, instead, those costs grew at the same rate as income—a scenario that illustrates the pure effect of demographic changes on the two programs—then the change in spending by 2050 would be much smaller. Indeed, that change

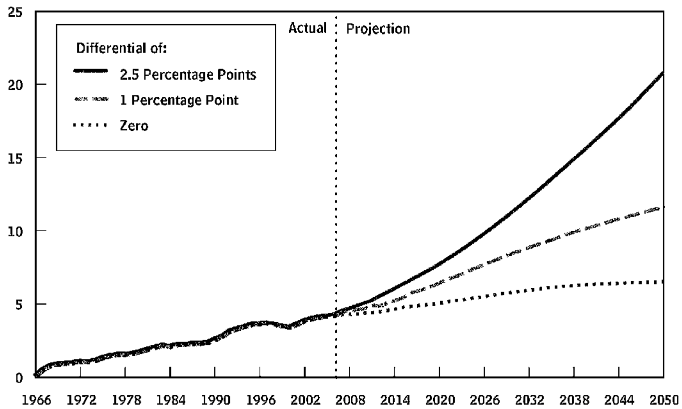
6. See the statement of Peter R. Orszag, Director, Congressional Budget Office, *Health Care and the Budget: Issues and Challenges for Reform*, before the Senate Budget Committee (June 21, 2007). See also Congressional Budget Office, *The Outlook for Social Security* (June 2004), *The Long-Term Budget Outlook* (December 2005), and *Updated Long-Term Projections for Social Security* (June 2006).

7. See Congressional Budget Office, *The Long-Term Budget Outlook*, pp. 6–7 and 31–32.

Figure 2.

Total Federal Spending for Medicare and Medicaid Under Assumptions About the Health Cost Growth Differential

(Percentage of gross domestic product)



Source: Congressional Budget Office.

Note: The health cost growth differential refers to the number of percentage points by which the growth of annual health care spending per beneficiary is assumed to exceed the growth of nominal gross domestic product per capita, after an adjustment for the growth and aging of the Medicare and Medicaid populations.

would be substantially smaller than the difference between the two scenarios. Thus, the rate at which health care costs grow relative to income is the most important determinant of the long-term fiscal balance; it exerts a significantly larger influence on the budget over the long term than other commonly cited factors, such as the aging of the population.

Controlling those federal costs over the long term will be very difficult without addressing the underlying forces that are also causing private costs for health care to rise. A variety of evidence, however, suggests that opportunities exist to constrain health care costs both in the public programs and in the rest of the health care system without adverse health consequences. Capturing those opportunities to reduce costs without harming health outcomes involves many challenges, including the time that may be necessary to generate significant savings—but even if reforms take time to generate savings, acting sooner rather than later can ultimately make a substantial difference. Those crucial fiscal issues are not directly addressed by PAYGO rules. Indeed, many steps that hold the potential to reduce spending over the long term—such as investments in comparative effectiveness research on "what works and what doesn't" in health care—typically involve short-term costs that would have to be offset under existing PAYGO rules.

Issues in Reinstating a Statutory PAYGO Requirement

Both the House and the Senate already have nonstatutory PAYGO rules in place. Reinstating a statutory PAYGO requirement might provide a more permanent structure and would make possible enforcement mechanisms, like sequestration, that cannot be established by House and Senate rules. However, it would involve significant complexity because the Congress would have to balance the need for flexibility with the desire to make the threat of sequestration as meaningful as possible. A statutory PAYGO requirement, as opposed to a nonstatutory PAYGO rule, could also provide some measure of additional authority to the executive branch. The Congress has a strong interest in defining that authority as specifically as possible. In addition to those considerations, any PAYGO system requires a set of scoring rules, concepts, and baseline requirements. One important purpose of those implementation rules is to ensure consistency between PAYGO scoring and the underlying budget baseline.

Scoring Rules, Concepts, and Baseline Requirements

In enacting the BEA, the Congress established a set of cost estimation rules, concepts, and baseline requirements so that PAYGO and other budgetary processes would work consistently and predictably. The rules established in 1990 are in large measure still followed, although their underlying statutory bases have expired. Issues surrounding the baseline and scoring rules arise from time to time, and those could be revisited if a statutory PAYGO requirement was adopted.

Scope and Application of a PAYGO Requirement. In recent years, lawmakers have debated whether the PAYGO requirement, in either a statutory or rules-based form, should apply to both spending and revenue legislation or to spending legislation alone. If the primary objective of the PAYGO requirement is to keep the fiscal outlook from deteriorating because of policy changes, no differential treatment would seem to be warranted for a policy change that increased mandatory spending relative to one that decreased revenues. Policy changes that increase mandatory spending by $1 or that reduce revenues by $1 and that are not offset by policy changes elsewhere in the budget both increase the budget deficit by $1. (In either case, scoring that ignores macroeconomic feedback effects may give an incomplete picture of the overall impact on the budget. In most cases, however, such macroeconomic feedback effects tend to be modest and difficult to estimate.) In addition, exempting all revenue changes from a PAYGO requirement while continuing to apply such a requirement to all mandatory spending changes would create substantial incentives to shift policy changes toward increased tax expenditures, even in cases in which they would be less effective than increased direct spending.

Including changes in revenue legislation within PAYGO, however, might impede other policy objectives. For example, proponents of extending previously enacted tax provisions that are scheduled to expire note that including such extensions within PAYGO requirements might make the extensions more difficult to enact.

A related issue involves the treatment of expiring spending and revenue provisions under the budget baseline used for PAYGO purposes. A fundamental principle for the integrity of the budget process is that, when a particular policy or program has a set expiration date, its long-term cost should be scored either at the time of enactment or when it is extended beyond the expiration date. Current scoring rules are intended to produce that outcome, though they treat taxes and spending programs differently. For most revenue legislation, expiring provisions of law are not scored or included in baseline projections beyond the year in which the provisions expire.[8] If those provisions are subsequently extended, the estimated costs are scored and captured at that time. On the spending side, most expiring mandatory programs that exceed $50 million are assumed to continue, both in the initial scoring and in the baseline budget projections.[9] The cost of such "temporary" programs, including the extension past their official expiration, shows up at the time of initial enactment and is then subsequently included in the baseline. In both cases, current and future costs are captured, either at the time of initial enactment or when the program is extended.[10] By contrast, scoring expiring provisions as entailing no budgetary cost after their expiration, but then assuming their extension in the baseline, would cause the costs of extending those provisions to "disappear" from the process—which would substantially undermine its integrity. The principle that costs of extending temporary provisions should be recorded at some point in the process is an important one, though it can be achieved in a variety of ways.

8. Expiring excise taxes that are dedicated to a trust fund are assumed to continue in the initial scoring and in the baseline projections. See section 257 of the Deficit Control Act (2 U.S.C. 907) as amended by title X of the Balanced Budget Act of 1997, P.L. 105-333, 111 Stat. 251, 677-712.

9. Ibid. All programs established on or before August 5, 1997, with outlays that exceed $50 million are assumed to continue in the scoring and the baseline projections. The scoring and baseline treatment of programs established after that date is determined by consultation with the Budget Committees.

10. When the budget window rolls forward every calendar year, the fundamental principle may no longer hold. In particular, consider a 10-year budget window. As that window rolls forward into the 11th year, the costs of extending a temporary mandatory program in that year are generally incorporated into the baseline even though they may not have been offset when the program was originally enacted.

Another issue involves emergencies. The BEA excluded from PAYGO calculations any spending or revenue legislation declared to be an emergency requirement by the President and the Congress.[11] However it is fashioned, an emergency safety-valve procedure of some type that allows additional resources to be provided for unexpected contingencies would probably be essential to allow the government to address unanticipated and pressing needs. Too much flexibility, however, could reduce the effectiveness of a PAYGO requirement.

Scope of Sequestration. The BEA set out special procedures for sequestration should discretionary caps or PAYGO limits be exceeded, including which federal programs were not subject to sequestration in each case.[12] Reinstatement of a statutory PAYGO requirement would require lawmakers to review sequestration procedures and update the list of exempt mandatory programs to take into account legislation enacted after the Balanced Budget Act of 1997.[13] Moreover, the Congress may want to review in general the nature and size of exempt mandatory programs. Under the expired PAYGO process, if a sequestration was triggered, the total amount of spending available to cut, because of specific exemptions and special rules, was quite limited. The bulk of any sequestration reductions would have fallen on a relatively small pool of mandatory spending. For fiscal year 2003, CBO estimated that less than $65 billion in mandatory outlays would have been subject to a PAYGO sequestration, an amount that was less than 5 percent of total mandatory outlays for the year.

Options for Structuring PAYGO Requirements

One striking way in which the current House PAYGO rule differs from the prior statutory PAYGO requirement is its application to each separate House bill rather than to a broader collection of legislative proposals. The House's PAYGO rule applies on a bill-by-bill basis, without reference to action on other bills affecting direct spending or revenues. Consequently, it does not allow savings from prior bills to cover the costs of a pending bill.

11. The emergency designation under the BEA applied to both the discretionary spending limits and the PAYGO requirement. The use of the emergency exclusion, especially for discretionary appropriations after 1998, led lawmakers and others to question whether much emergency spending was for true emergencies or was simply a way to appropriate more funds without having to find offsets.

12. Programs that were exempt from sequestration include Social Security and other retirement benefits, Medicaid, Temporary Assistance for Needy Families, veterans programs, power marketing administrations, most insurance programs, and the refundable portion of the earned income tax credit. See section 255 of the Deficit Control Act (2 U.S.C. 905). Similarly, most Medicare spending was not subject to sequestration because of a special rule. See section 256(d) of the Deficit Control Act (2 U.S.C. 906(d)).

13. One shortcoming of the BEA was that it did not address the treatment of new programs. Each time the BEA was extended, the Congress had to consider updating the exemptions and exclusions. Lawmakers might consider creating a framework for how to treat new programs.

In that regard, the House and Senate PAYGO rules differ. Enforcement of the Senate's rule relies on the monitoring of a PAYGO scorecard maintained by the Senate Budget Committee. The rule prohibits the consideration of legislation that would increase the deficit when taken individually and when taken together with legislation enacted since the beginning of the year.[14] That approach effectively allows the Senate to "bank" savings against future spending legislation.

The PAYGO requirement as enacted in the BEA adopted a third approach. It assessed the net effect of all direct spending and revenue legislation enacted during a session in determining whether sequestration would occur. The budgetary impact of each measure was recorded by the director of OMB on a rolling multiyear PAYGO scorecard. Direct spending or revenue legislation that achieved savings, therefore, could offset the impact of other legislation that entailed costs. Because sequestration could not practically be implemented on a bill-by-bill basis, such an approach is inherent to that enforcement mechanism; it is not essential, however, for enforcement based on parliamentary points of order.

Unlike Congressional rules, the statutory PAYGO requirement provided a measure of authority to the executive branch by assigning responsibility to OMB to calculate the year-end deficit increase or decrease for sequestration purposes. That approach accorded with the constitutional restrictions on legislative branch organizations articulated by the Supreme Court in *Bowsher v. Synar.*[15] In reinstituting a statutory PAYGO requirement, lawmakers might reconsider the timelines, roles, and responsibilities of the Budget Committees, CBO, and OMB in order to retain as much responsibility for the process as possible. For example, for purposes of a statutory PAYGO requirement, the Congress could require OMB to use the Budget Committees' estimates of the cost of legislation, as long as the estimates were embedded in the enacted legislation.[16]

With the expiration of caps on categories of discretionary spending in the BEA, budget resolutions have been the primary method of controlling discretionary spending. Legislation establishing and extending discretionary caps under the BEA with its PAYGO requirement provided a comprehensive structure for a form

14. Beginning in May 2007, estimates used to enforce the Senate's PAYGO rule are made relative to the baseline used for the most recent budget resolution. See section 201(a)(5) of S. Con. Res. 21. In prior years, such estimates were made relative to the baseline adjusted for any changes or direct spending assumed by the budget resolution. Thus, assumed legislation was excluded from enforcement under the Senate's prior PAYGO rule.

15. In *Bowsher*, the Supreme Court held that having the Comptroller General, an official accountable to the Congress, trigger sequestrations was unconstitutional because it impermissibly reserved in the Congress control over the execution of the laws. 478 U.S. 714, 726 (1986).

16. The Budget Committees determine all estimates used to enforce Congressional budget procedures. To assist the Budget Committees, CBO analyzes the spending or revenue effects of specific legislative proposals. For proposals that would amend the Internal Revenue Code, CBO is required by law to use estimates provided by the Joint Committee on Taxation.

of fiscally responsible budgeting. But, even within such a comprehensive structure, which captured any medium-term effects on the budget, the long-term effects were sometimes different. Revisiting the issue of a statutory PAYGO requirement might provide an opportunity to consider rules governing long-term budgetary effects.[17]

17. For instance, the Senate PAYGO rule is buttressed by another rule in the fiscal year 2008 budget resolution (section 203 of S. Con. Res. 21) that prohibits the consideration of legislation increasing the deficit by more than $5 billion in any of the four 10-year periods covering fiscal years 2018 to 2057.

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

STATEMENT OF DAVID M. WALKER

Mr. WALKER. Thank you, Mr. Chairman, Ranking Member Ryan. Thank you for putting the entire statement in the record. It is good to be here today.

I would like to use a few slides to make a few key points so then we can go to Q and A. First slide, please.

I think it is important to look back and learn from the past as we try to prepare to create a better future. As you can see here, since 1962, mandatory spending has grown dramatically and discretionary spending continues to be squeezed and is expected to continue to be squeezed.

Interestingly, if you go back to 1797, the end of the second term of President George Washington, you will find that all the major functions of government in 1797 are now in discretionary spending. So what the major functions of governments were at the beginning of our Republic are now getting squeezed, national defense, homeland security, judicial system, Legislative Branch, Executive Office of the President, foreign affairs, Attorney General, et cetera.

Next, please.

In January of 2001 when I testified before the Senate and the House, we had fiscal sustainability for 40 plus years. We were expected to pay off the national debt and, therefore, you can look and see that there was no projection for any net interest payments going forward because we were projected to pay off the national debt. For a variety of reasons, we have changed paths. Here is the latest baseline future simulation. Next chart, please.

This is based upon the CBO baseline extended and CBO does a great job. We work together on a very complementary basis. But, frankly, CBO has certain restrictions placed on them as to what they have to assume for their baseline assumptions.

For example, that all tax cuts will expire, that discretionary spending will grow by the rate of inflation for a period of time, that AMT will not be fixed. And so, therefore, if you look at this, things really look better than they really are.

Next, please.

This represents an alternative fiscal future based upon a more realistic set of assumptions. One of the assumptions is that over the longer term that the U.S. taxes at historical tax levels, about 18.4 percent of GDP, it assumes that we do not reform Social Security and Medicare and it assumes that discretionary spending over the longer term grows by the rate of the economy.

As you can see, this is a clearly unacceptable fiscal future. The largest growing expense is interest on the rising national debt. And by the way, the model which drives this blows up in the 2040s.

Next, please.

Or crashes stated differently. If you look at the path that we are on, the big three programs, Social Security, Medicare, and Medicaid are set to consume 100 percent of the historical levels of taxation of the federal government by the mid 2040s.

Next, please.

This is an alternative way of looking at what the deficit looks like going forward under the baseline and alternative simulation.

Next, please.

Last week for the first time in history, GAO issued a fiscal simulation for state and local governments in the aggregate. And this shows with the red line that when you look at the federal surplus or deficit, it is only a portion of the problem because state and local governments starting in about 2017, which, by the way, is the year that Social Security surplus turns negative and we go to a deficit for Social Security on a cash flow basis, they start having serious problems that grow over time driven primarily by healthcare. Healthcare is driving the federal deficit, it is driving state deficits, and it is driving the undercutting of the U.S. competitiveness from a business standpoint. So healthcare is the big challenge.

Next, please.

You know, PAYGO rules, which I will touch on in a second, are one positive step, I believe, that could help us to get on a more prudent and sustainable path, but they are only one of many that are necessary.

One of the things that we need to do is we need to improve transparency and enhance accountability with regard to where we are financially and where we are headed fiscally. We need to recognize that the United States is going to last more than ten years and move beyond the flat earth theory for budget analysis and to recognize that our real problems are not the next five years or ten years. They are not short-term deficits. They are long-range, growing structural deficits and related debt burdens that could swamp our ship of state.

This represents a summary of something that we sent up to this Committee and others for consideration to enhance transparency and accounting and budgeting. This is a beginning, not an end. This is a follow-up to my testimony in January earlier this year. We are working with CBO and OMB and others to try to be able to address their comments and concerns.

I am confident that we will be able to do that over a period of time, but I think it is important that we recognize that in addition to controls, we need more transparency because that is going to be necessary in order to not just deal with discretionary spending but also to deal with mandatory and the revenue side.

Now, on the PAYGO, if I can. When I appeared before the Committee, I noted as I have before that GAO believes that it is important to consider reestablishing statutory PAYGO rules on both sides of the ledger, on both the spending side and the tax side of the ledger.

As I have said before, we need to learn from the first rule of holes and that is when you are in a hole, the first thing you have to do is stop digging. Discretionary caps and PAYGO are designed to stop the digging, but there are at least two reasons to impose PAYGO on both direct spending and the revenue side of the budget.

The first is obvious. Both affect the bottom line. It is the net of revenues and expenditures that affect the bottom line.

The second is just as important, but not as obvious, and that is if you only apply PAYGO on one side of the ledger, then what is likely to occur over time is an increase of back-door spending in the form of tax preferences.

Tax preferences or tax expenditures represent back-door spending. They are largely off the radar screen. They are not part of the normal budget appropriations process. They are not part of the annual financial report of the U.S. government. They cost us 800 to $900 billion a year in foregone revenue. They need more transparency and they should not be off the radar screen.

They also are like mandatory spending in which they are not subject to periodic review. They are not subject to periodic reauthorization. They are in the base and they are assumed to continue. It would be very unfortunate if the restoration of the PAYGO rule were to lead to an increase in the portion of our financial situation that is on automatic pilot and, therefore, reduce transparency and control.

As has been mentioned by Peter, PAYGO makes a lot of sense, but we need other budget controls. And, furthermore, we also are going to need to reform entitlement programs as well as engage in comprehensive tax reform in order to put our fiscal house in order.

In closing, our fiscal clock is ticking and time is working against us. For the sake of our country, our children, our grandchildren, we need to start to act because our future is at risk. And if we want to keep America great, we are going to have to start making some tough choices. And the longer we wait, the more dramatic the changes are going to have to be, the less transition time, and the higher level of risk that we might face some crisis which does not necessarily promote sound decision making.

Thank you.

[The prepared statement of David M. Walker follows:]

United States Government Accountability Office

GAO

Testimony
Before the Committee on the Budget, House of Representatives

For Release on Delivery
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LONG-TERM FISCAL CHALLENGE

Additional Transparency and Controls Are Needed

Statement of David M. Walker
Comptroller General of the United States

GAO
Accountability * Integrity * Reliability

GAO-07-1144T

Chairman Spratt, Mr. Ryan, Members of the Committee,

I appreciate being invited to testify today as you consider the restoration of a statutory pay-as-you go rule(s), or PAYGO. As this Committee knows as well or better than any, this discussion is part of the broader question: How should we deal with our nation's long-term fiscal challenge in order to help ensure that our future is better than our past?

In my testimony today, I will start with our longer-term fiscal challenge. Then I will turn to the process question you present at this hearing: the reimposition of a statutory PAYGO rule(s) as a step toward dealing with this challenge. Finally I will talk about moving beyond caps and PAYGO to some ideas on how improved transparency and process changes can help in the effort to put us on a more prudent and sustainable long-term fiscal path.

As widely reported earlier this month, the Administration now expects the deficit for fiscal year 2007 to be $205 billion, down from its February estimate of $244 billion and last year's deficit of $248 billion. However, because these numbers include the Social Security surpluses, they mask what I like to call the "operating deficit" now estimated to be $385 billion for fiscal year 2007. Clearly lower short-term deficits are better than higher short-term deficits. However, our real challenge is not short-term deficits, rather it's the long-term structural deficits and related debt burdens that could swamp our ship of state if we do not get serious soon. Specifically, while our near-term fiscal picture is better, our long-term fiscal outlook is not. Health care costs are still growing faster than the economy and the population is still aging. Indeed, what we call the long-term fiscal challenge is not in the distant future. The first of the baby boomers become eligible for early retirement under Social Security on January 1, 2008—less than 1 year from now— and for Medicare benefits in 2011—just 3 years later. The budget and economic implications of the baby boom generation's retirement have already become a factor in Congressional Budget Office's (CBO) 10-year baseline projections and will only intensify as the baby boomers age. Simply put, our nation is on an imprudent and unsustainable long-term fiscal path that is getting worse with the passage of time.

Herbert Stein once said that something that is not sustainable will stop. That, however, should not give us comfort. Clearly, it is more prudent to change the path than to wait until a crisis occurs. While restraint in the near term and efforts to balance the budget over the next 5 years can be positive, they are not enough. It is also important that we take steps to address our longer-term fiscal imbalance. The real problem is not the near-term deficit—it is the long-term fiscal outlook. It is important to look beyond year 5 or even year 10. Both the budget and the budget process need more transparency over and focus on the long-term implications of current and proposed spending and tax policies. I will suggest a number of things that I believe will help in this area in this testimony.

My remarks are based on our previous work on a variety of issues, including reports and testimonies on our nation's long-term fiscal challenges and budget process reform. These efforts were conducted in accordance with generally accepted government auditing standards.

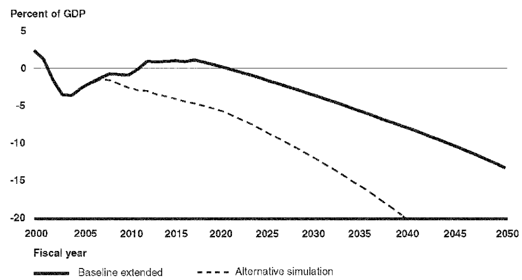
The Nation's Long-Term Fiscal Challenge

Long-term fiscal simulations by GAO, CBO, and others all show that despite some modest improvement in near-term deficits, we face large and growing structural deficits driven primarily by rising health care costs and known demographic trends. In fact, the long-term fiscal challenge is largely a health care challenge. Although Social Security is important because of its size, the real driver is health care spending. It is both large and projected to grow more rapidly in the future.

GAO's current long-term simulations show ever-larger deficits resulting in a federal debt burden that ultimately spirals out of control. Figure 1 shows two alternative fiscal paths. The first is "Baseline extended," which extends the CBO's baseline estimates beyond the 10-year projection period, and the second is an alternative based on recent trends and policy preferences. Our alternative scenario assumes action to return to and remain at historical levels of revenue and reflects somewhat higher discretionary spending and more realistic Medicare estimates for physician payments than does the baseline extended scenario.[1] Although the timing of deficits and the resulting debt build up varies depending on the assumptions used, both simulations show that we are on an unsustainable fiscal path.

[1]Additional information about the GAO model and its assumptions, data, and charts can be found at http://www.gao.gov/special.pubs/longterm/.

Figure 1: Unified Surpluses and Deficits as a Share of GDP under Alternative Fiscal Policy Simulations

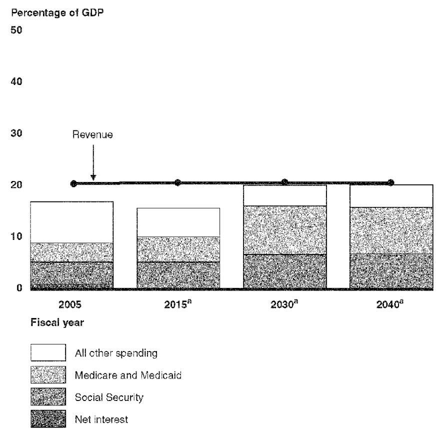


Source: GAO's April 2007 analysis.

The bottom line is that the nation's longer-term fiscal outlook is daunting under any realistic policy scenario or assumptions. Continuing on this unsustainable fiscal path will gradually erode, if not suddenly damage, our economy, our standard of living, and ultimately our national security. Our current path also increasingly will constrain our ability to address emerging and unexpected budgetary needs and increase the burdens that will be faced by future generations.

As I noted earlier, despite some recent improvements in short-term deficits, the long-term outlook is moving in the wrong direction. Figures 2 and 3 illustrate just how much worse the situation has become. Both figures show the potential fiscal outcome under our "Baseline extended" scenario. Figure 2 shows the fiscal outlook in 2001 and figure 3 shows the outlook now. The contrast is dramatic. Even with the surpluses of 2001, we had a long-term problem, but it was more than 40 years out. Although an economic slowdown and decisions driven by the attacks of 9/11 and the need to respond to natural disasters have contributed to the change in outlook, they do not account for the dramatic worsening in the long-term outlook since 2001. Subsequent tax cuts and the passage of the Medicare prescription drug benefit in 2003 were major factors.

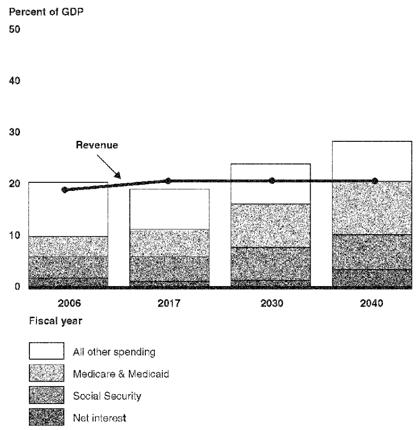
Figure 2: Potential Fiscal Outcomes under Baseline Extended, January 2001: Revenue and Composition of Spending as a Share of GDP



Source: GAO's January 2001 analysis.

[a]All other spending is net of offsetting interest receipts.

Figure 3: Potential Fiscal Outcomes under Baseline Extended, April 2007: Revenue and Composition of Spending as a Share of GDP

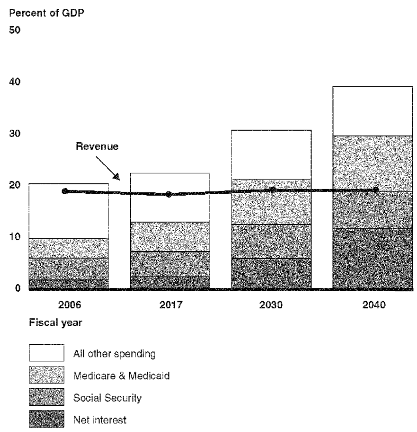


Source: GAO's April 2007 analysis.

Notes: In addition to the expiration of tax cuts, revenue as a share of GDP increases through 2017 mainly due to (1) real bracket creep, (2) more taxpayers becoming subject to the AMT, and (3) increased revenue from tax-deferred retirement accounts. After 2017, revenue as a share of GDP is held constant—implicitly assuming that action is taken to offset increased revenue from real bracket creep, the AMT, and tax-deferred retirement accounts.

Figure 3 illustrates today's cold hard truth: that neither slowing the growth in discretionary spending nor allowing the tax provisions to expire—nor both together—would eliminate the longer-term imbalance. This is even clearer under our alternative scenario based on recent trends and policy preferences (see fig. 4). Growth in the major entitlement programs—primarily health spending—results in an unsustainable fiscal future regardless of whether one assumes future revenue will be somewhat above historical levels as a share of the economy as in the first simulation (fig. 3) or at historical levels as shown in figure 4.

Figure 4: Potential Fiscal Outcomes under Alternative Simulation, April 2007: Revenues and Composition of Spending as a Share of GDP



Source: GAO's April 2007 analysis.

Notes: AMT exemption amount is retained at the 2006 level through 2017 and expiring tax provisions are extended. After 2017, revenue as a share of GDP returns to its historical level of18.3 percent of GDP plus expected revenues from deferred taxes, i.e. taxes on withdrawals from retirement accounts. Medicare spending is based on the Trustees April 2007 projections adjusted for the Centers for Medicare and Medicaid Services alternative assumption that physician payments are not reduced as specified under current law.

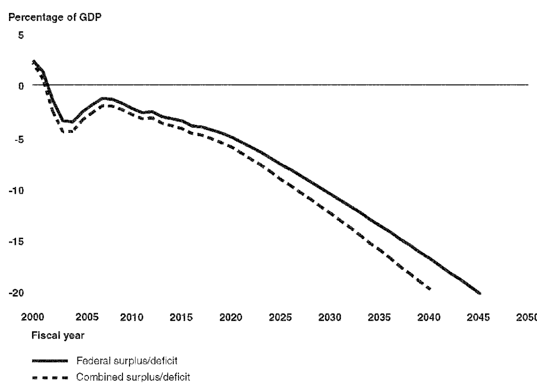
Rapidly rising health care costs are not simply a federal budget problem; they are our nation's number one fiscal challenge. Just last week, GAO released the results of our latest fiscal modeling efforts showing that state and local governments—absent policy changes—will also face large and growing fiscal challenges beginning within the next few years.[2] As is true for the federal budget, growth in health-related spending—Medicaid and health insurance for state and local employees and retirees—is the

[2]See GAO, *State and Local Governments: Persistent Fiscal Challenges Will Likely Emerge within the Next Decade* GAO-07-1080SP (Washington, D.C.: July 18, 2007).

primary driver of the fiscal challenges facing the state and local governments. In short, the fundamental fiscal challenges of all levels of government are similar and linked. Further, escalating health care costs are also a major competitiveness challenge for American businesses and a growing challenge for many Americans. As such, solutions to address these challenges should be considered in a strategic and integrated manner.

The longer-term fiscal challenge we face is not solely a federal one—it is a national one. Figure 5 shows both the federal fiscal path and the fiscal path for the whole of government.

Figure 5: Federal and Combined Federal, State, and Local Surpluses and Deficits as a Share of GDP



Source: Historical data from National Income and Product Accounts, GAO analysis.

Note: Historical data from 2000-2006, projections from 2007-2050; state and local balance measure is similar to the federal unified budget measure.

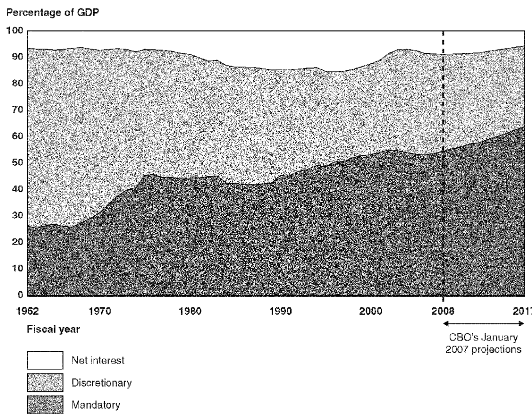
Mandatory Spending Programs Drive the Long-term Fiscal Outlook

There often seems to be an imbalance between the focus of press coverage and public debate and what drives the longer-term outlook. Reporting and debate are often focused on what the Budget Enforcement Act (BEA) called discretionary—the one-third of the budget that goes through the annual appropriation process.[3] Is funding for specific programs being cut or increased? Is "too much" or "too little" being spent in a given area? I would be the last person to say this isn't important. Much of what the American people think of as government is contained in that part of the budget. Further, as I have said before, I believe that reexamining "the base" is something that should be done periodically regardless of fiscal condition—all of us have a stewardship obligation over taxpayer funds. We have programs still in existence today that were designed 20 or more years ago—and the world has changed. However, I would suggest that as constraints on discretionary spending continue to tighten, the need to reexamine existing programs and activities becomes greater.

Certainly controlling discretionary spending is important, but—as everyone in this room knows even with the large costs associated with the "Global War on Terrorism" and Iraq—discretionary spending is not the part of the budget that drives the long-term fiscal imbalance. As figure 6 shows, mandatory programmatic spending—that is mandatory spending excluding interest—has grown from 27 percent of the federal budget in 1965—the year Medicare was created—to 42 percent in 1985 to 53 percent last year. Total mandatory spending including net interest—has grown from 34 percent in 1965 to 62 percent last year. Both the CBO baseline estimates and the President's Budget proposal show this spending growing even further.

[3] *See* 2 U.S.C. § 900(c)(7).

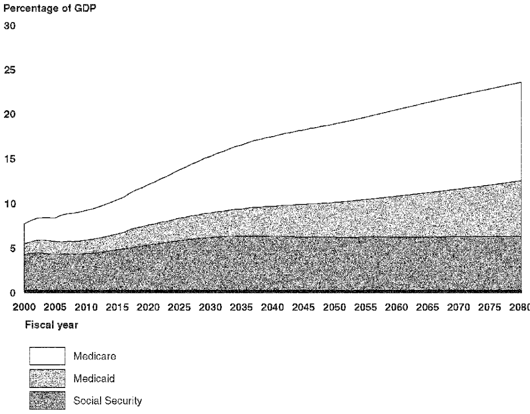
Figure 6: Federal Spending for Mandatory and Discretionary Programs



Source: Office of Management and Budget and the Congressional Budget Office.

This growth—in particular rising health care spending—will have significant implications not only for the budget, but also for the economy as a whole. Figure 7 shows the total future draw on the economy represented by Social Security, Medicare, and Medicaid. Under the 2007 Trustees' intermediate estimates and CBO's 2005 midrange Medicaid estimates, spending for these entitlement programs combined will grow to over 15 percent of GDP in 2030 from today's 8.9 percent. Taken together, it is clear that Social Security, Medicare, and Medicaid represent an unsustainable burden on the federal budget, our economy, and future generations. Ultimately, the nation will have to decide what level of benefits and spending it wants and how it will pay for these benefits.

Figure 7: Social Security, Medicare, and Medicaid Spending as a Percentage of GDP



Source: GAO analysis based on data from the Office of the Chief Actuary, Social Security Administration, Office of the Actuary, Centers for Medicare and Medicaid Services, and the Congressional Budget Office

Note: Social Security and Medicare projections based on the intermediate assumptions of the 2007 Trustees' Reports. Medicaid projections based on CBO's January 2007 short-term Medicaid estimates and CBO's December 2005 long-term Medicaid projections under mid-range assumptions.

Although these three programs dominate the long-term outlook, they are not the only federal programs or activities that bind the future. The federal government undertakes a wide range of responsibilities, programs, and activities that may either obligate the government to future spending or create an expectation for such spending. Part of what we owe the future is leaving enough flexibility to meet whatever challenges arise. So beyond dealing with the "big 3," we need to look at other policies that limit that flexibility—not to eliminate all of them but to at least be aware of them and make a conscious decision to reform them in a manner that will be responsible, equitable, and sustainable. GAO has described the range and measurement of such fiscal exposures—from explicit liabilities such as environmental cleanup requirements to the more implicit obligations presented by life-cycle costs of capital acquisition or disaster assistance.

Last year the U.S. government's major reported liabilities, social insurance commitments, and other fiscal exposures continued to grow. They now total approximately $50 trillion—about four times the nation's total output (GDP) in fiscal year 2006—up from about $20 trillion, or two times GDP in fiscal year 2000. Absent meaningful reforms, these amounts will continue to grow every second of every minute of every day due to continuing deficits, known demographic trends and compounding interest costs. While it is hard to make sense of what "trillions" means, one way to think of these numbers is that if we wanted to put aside today enough to cover these promises, it would take $170,000 for each and every American, including newborns, or approximately $440,000 per American household. Considering that median household income is about $46,000, the household burden is about 9.5 times median income.

Just two weeks ago the Office of Management and Budget released its mid-session budget update—showing further improvement in this year's budget deficit. This "good news," however, did not signal any improvement in the long-term outlook. The problem isn't this year's deficit—or even the deficit in 2012. The problem is that we are on an imprudent and unsustainable path.

Budget Controls Step 1: Stop Digging

When I appeared before this Committee in January[4] I noted that I have previously urged a restitution of the statutory budget controls—including meaningful caps on discretionary spending and PAYGO on both the tax and spending sides of the ledger. Given the focus of this hearing, let me elaborate.

BEA—of which PAYGO was a part—had a number of strengths its predecessor, Gramm-Rudman-Hollings, lacked.[5] Consistent with good practice in designing incentives, it focused on what Congress and the administration could control—spending and tax decisions—rather than on outcomes driven by external changes. In addition, enforcement was targeted—further encouraging compliance with the discretionary caps and

[4]GAO, *Long-Term Budget Outlook: Deficits Matter–Saving Our Future Requires Tough Choices Today,* GAO-07-389T (Washington, D.C.: Jan. 23, 2007) (Testimony before the House Committee on the Budget).

[5]Budget Enforcement Act of 1990, Pub. L. No. 101-508, title XIII, 104 Stat. 1388, 1388-573 (Nov. 5, 1990); Balanced Budget and Emergency Deficit Control Act of 1985, Pub. L. No. 99-177, title II, 99 Stat. 1037, 1038 (Dec. 12, 1985).

PAYGO rules. There is broad consensus among observers and analysts who focus on the budget that the controls contained in the Budget Enforcement Act constrained spending for much of the 1990s. However, since the BEA was focused on deficit reduction, its effectiveness deteriorated with the achievement of near-term surpluses. Although the BEA statutory PAYGO rules were extended twice, they expired in 2002.

Earlier this year, both the Senate and the House adopted rules reinstating PAYGO discipline on both sides of the ledger. Then why should we consider restoration of statutory PAYGO? The obvious answer ties to enforcement and duration: it may be easier to waive a rule than ignore a law, and a law can carry a penalty designed to encourage compliance. I will defer to Director Orszag and some of the technical experts on the next panel as to the details of how any sequester or enforcement mechanism should be designed. However, I will note that it should be unpleasant enough to encourage compliance but not so draconian as to be implausible. The goal of any penalty should be to encourage compliance, not to encourage avoidance or merely impose the penalty.

As I have said before, when you are in a hole, the first thing to do is stop digging. Discretionary caps and PAYGO are designed to stop the digging. There are two reasons to impose PAYGO on both the direct spending and the revenue side of the budget. The first is obvious—both affect the bottom line. The second—and perhaps as important—is that applying PAYGO only to spending is likely to lead to more programs being designed as tax preferences. Tax preferences are like a form of back door spending. As a result, they need to be subject to additional transparency and controls as well. We have previously reported[6] on these tax expenditures, which are often aimed at policy goals similar to those of federal spending programs. Revenues forgone through tax expenditures—unless offset by increased taxes or lower spending—increase the unified budget deficit and federal borrowing from the public (or reduce the unified budget surplus available to reduce debt held by the public). Unlike discretionary spending programs, which are subject to periodic reauthorization and annual appropriation, tax expenditures are—like entitlement programs—permanent law and generally not subject to a recurring legislative process that would ensure systematic annual or periodic review. BEA's statutory

[6]GAO, *Government Performance and Accountability: Tax Expenditures Represent a Substantial Federal Commitment and Need to Be Reexamined*, GAO-05-690 (Washington D.C.: Sept. 23, 2005).

PAYGO regime applied to both mandatory spending and revenues—and so limited the ability to create or expand either spending entitlements or tax expenditures unless offsetting funds could be raised. Since tax provisions are not as visible in the budget as spending programs, there is already some incentive to use tax provisions rather than spending programs to accomplish programmatic ends; imposing controls on spending programs but not on tax provisions would only increase this incentive. It would be an unfortunate consequence if the restoration of the PAYGO rule were to lead to an increase in the portion of the budget on automatic pilot and therefore reduce both transparency and control.

Moving Beyond PAYGO: Process and Presentational Changes to Increase Transparency and Focus on Long-Term Consequences

The PAYGO requirement prevented legislation that lowered revenue, created new mandatory programs, or otherwise increased direct spending from increasing the deficit unless offset by other legislative actions. While PAYGO constrained the creation or legislative expansion of direct spending programs and tax cuts, it accepted the existing provisions of law as given. It was not designed to trigger—and it did not trigger—any examination of "the base." Furthermore, cost increases in existing mandatory programs were exempt from control under PAYGO and could be ignored. However, constraining legislative actions that increase the cost of entitlements, mandatories, and tax expenditures is not enough. Looking ahead, the budget process will need to go beyond limiting expansions. Existing programs cannot be permitted to be on autopilot and grow to an unlimited extent. Since the spending for any given entitlement or other mandatory program is a function of the interaction between eligibility rules and the benefit formula—either or both of which may incorporate exogenous factors such as economic downturns—the way to change the path of spending for any of these programs is to change their rules or formulas. In January of last year, we issued a report on "triggers"—some measure that when reached or exceeded, would prompt a response connected to that program.[7] By identifying significant increases in the spending path of a mandatory program relatively early and acting to constrain it, Congress may avert much larger and potentially disruptive financial challenges and program changes in the future. A similar approach could be applied to those tax expenditures that operate in many ways like mandatory spending programs. Some years ago, Mr. Chairman, you had suggested a kind of "look back" trigger—a requirement that the President

[7]GAO, *Mandatory Spending: Using Budget Triggers to Constrain Growth*, GAO-06-276 (Washington, D.C.: Jan. 31, 2006).

and the Congress monitor the path of existing entitlements and make an explicit determination about whether to accept growing costs or to take action to change the path.

I know it comes as no surprise to anyone in this room that I believe we need to increase the understanding of and focus on the longer term in our policy and budget debates. When I was here in January I spoke about some ideas I had been discussing with a number of Members of the House and Senate as well as other interested and concerned citizens and groups. Since then—at the request of some Members—I have had those ideas put into legislative language as a basis for discussion. Today I'd like to elaborate a little on some of those ideas. They fall into three broad categories: increased information and reporting by the executive branch—both in the President's budget proposal and in other statements for the public; more information for the Congress, and an annual GAO report. I will discuss each in turn. A summary of the proposal appears in appendix I.

I. Executive Branch Reporting & Information

A. Increased Information in the President's Budget Proposals

- **Annual Report on Fiscal Exposures:** The transparency of existing commitments would be improved by requiring OMB to report annually on existing fiscal exposures—including a concise list, description and cost information.[8] As I noted before, these exposures range from explicit liabilities to implicit promises embedded in the structure of current programs. This should be provided as supplementary information in the President's budget along with information on the long-term costs of major tax expenditures. As appropriate and possible, showing tax expenditures, related spending programs and related credit programs that address the same policy area would facilitate oversight and reexamination by the Congress.
- **Information over a longer time horizon:** (1) The President's budget should include an estimate of the impact of any major spending or tax proposals on these fiscal exposures and on the long-term fiscal outlook; (2) The budget should provide year-by-year

[8]For more information on fiscal exposures, see GAO, *Fiscal Exposures: Improving the Budgetary Focus on Long-Term Costs and Uncertainties*, GAO-03-213 (Washington, D.C.: Jan. 24, 2003).

data for 10 fiscal years rather than the current 5; and (3) The President's budget should include a statement of his budgetary goals for the next decade.

B. Executive Branch Reporting and Information—Summary Annual Report and Statement of Fiscal Sustainability

- **Summary Annual Report:** One of the things I am proudest of from my tenure as a public trustee for Social Security and Medicare is the creation of a Summary Report to accompany the annual Trustees report. This summary report presents key information in a way more accessible to the press and lay reader. I believe it has contributed to improved understanding about the condition of these programs. As the Comptroller General I sign the audit report on the Consolidated Financial Statements of the U.S. Government (CFS). Despite the fact that we must disclaim our opinion on the statements I believe they contain important information. The report is, however, too thick and very hard to read. I believe the Department of the Treasury (Treasury) should publish a summary financial report derived from the information in the audited CFS and the Comptroller General's audit report on it within 15 days of the issuance of that audit report.
- Every four years the Treasury should do more—it should prepare and publish a fiscal sustainability report including information and an assessment of the long-term fiscal sustainability of our current spending and revenue path. A number of other Organization for Economic Co-operation and Development (OECD) countries have begun to do fiscal sustainability reports as a way of looking ahead. Such a report permits the public and policymakers to look at the full range of government commitments rather than focusing only on new proposals.

II. Additional Information for the Congress

- If Congress is to balance short-term claims and long-term costs it must have information about the long-term cost implications of proposals that would result in a significant increase or decrease in revenues or spending. I recognize that estimates over a multi-decade period cannot be as precise as short-term estimates and that some programs are harder to cost out than Social Security. However, information about the path should be made available. For example, do costs double every decade?

III. GAO Report

- As the independent auditor of the federal government's Consolidated Financial Statements and an agency of the legislative branch without a day-to-day responsibility in the budget process, I believe GAO is in an excellent position to pull together periodic financial and fiscal information in a summary report similar to the fiscal stewardship report I issued January 31 of this year. If Congress does impose additional transparency requirements on the Executive Branch, then we are in a good position to look over how those requirements were implemented and to suggest what changes, if any, might be made.

Meeting the Long-Term Fiscal Challenge Requires Truth, Transparency, Cooperation and Compromise—and Action Should not be Delayed Further

I think we all know that there is no easy way out of the large and growing longer-term fiscal challenge we face. Economic growth is essential, but we cannot grow our way out of the problem. Based on reasonable assumptions the math does not come close to working. I have said that the first thing to do is stop digging—and the restoration of credible discretionary caps and PAYGO on both the spending and tax side of the ledger can help with that. Important as they are, however, they are not enough.

Fundamental reform of existing entitlement programs will be necessary to change the path of those programs. The fact that the long-term outlook is driven primarily by health care costs does not mean that the rest of the budget should be exempt from scrutiny. We have the opportunity to bring our government and its programs in line with 21st century realities.[9] Those who believe we can solve this problem solely by cutting spending or raising taxes are not being realistic. The truth is we will also need to reform entitlement programs, re-prioritize and re-engineer other direct spending programs, and engage in comprehensive tax reform that generates additional revenue as a percent of the economy (compared to current and historical levels) in order to get the job done.

[9] GAO, *21st Century Challenges: Reexamining the Base of the Federal Government*, GAO-05-325SP (Washington, DC: February 2005) and *Suggested Areas for Oversight for the 110th Congress*, GAO-07-235R (Washington, D.C.: Nov. 17, 2006)

Concluding Remarks

I have long believed that the American people can accept difficult decisions as long as they understand why such choices are necessary. They need to be given the facts about the fiscal outlook: what it is, what drives it, and what it will take to address it. As most of you know, I have been investing a good deal of time in the Fiscal Wake-Up Tour (FWUT) led by the Concord Coalition. Scholars from both the Brookings Institution and the Heritage Foundation join with me and key Concord officials in laying out the facts and discussing the possible ways forward. In our experience, having these people with quite different policy views agree on the nature, scale and importance of the issue—and on the need to sit down and work together to develop a multi-dimensional solution to our longer-term fiscal challenge—resonates with the audiences.

The specific policy choices made to address this fiscal challenge are the purview of elected officials. The policy debate will reflect differing views of the role of government and differing priorities for our country. What the FWUT can do—and what I will continue to do—is lay out the facts, debunk various myths, discuss possible options and prepare the way for tough choices by elected officials. If the American people understand that there is no magic bullet—if they understand that

- we cannot grow our way out this problem;
- eliminating earmarks will not solve the problem;
- wiping out fraud, waste and abuse will not solve the problem;
- ending the "Global War on Terrorism", exiting from Iraq, or cutting way back on defense will not solve the problem; and
- letting the recent tax cuts expire will not solve this problem;

then they can engage with you in a discussion about what government should do; how it should do it; and how we should pay for it without unduly mortgaging the future of our country, children, and grandchildren. This is a great nation, probably the greatest in history. We have faced many challenges in the past and we have met them. It is a mistake to underestimate the commitment of the American people to their country, children, and grandchildren; to underestimate their willingness and ability to hear the truth and support the decisions necessary to deal with this challenge. We owe it to our country, children and grandchildren to address our fiscal and other key sustainability challenges. The clock is ticking and time is working against us. The time for action is now.

Chairman Spratt, Mr. Ryan, Members of the Committee, let me repeat my appreciation for your commitment and concern in this matter. We at GAO stand ready to assist you in this important effort.

Scope and Methodology

My remarks are based largely on previous reports and testimonies, such as Long-Term Budget Outlook: Deficits Matter—Saving Our Future Requires Tough Choices Today (GAO-07-389T) and Budget Process: Better Transparency, Controls, Triggers, and Default Mechanisms Would Help to Address Our Large and Growing Long-term Fiscal Challenge (GAO-06-761T). We updated these testimonies with the results from our most recent long-term simulations in The Nation's Long-Term Fiscal Outlook: April 2007 Update (GAO-07-983R).

Contact and Acknowledgments

Contact points for our Offices of Congressional Relations and Public Affairs may be found on the last page of this testimony. For further information on this testimony, please contact Susan J. Irving at (202) 512-9142 or irvings@gao.gov. Individuals making key contributions to this testimony include Jay McTigue, Assistant Director; Matthew Mohning, Senior Analyst and Melissa Wolf, Senior Analyst.

Appendix I: Transparency in Accounting and Budgeting: Legislative Recommendations of the Comptroller General

Supplemental Reporting in the President's Annual Budget Submission

- Produce as supporting information to the budget an annual Statement of Fiscal Exposures, including:
  - a concise list, dollar estimates, and descriptions of exposures, including—
    - information from Consolidated Financial Statements of the U.S. Government on total liabilities, contingencies, commitments, and net present value of social insurance program payments, and
    - long-term cost (> 40 years) of major tax expenditures, presented together with related spending or credit programs in the same policy area , if appropriate
  - dollar estimate of the effect on these exposures of all major spending or tax proposals
  - an assessment of methodologies and data used to produce such cost estimates
  - a graphic presentation of the dollar amounts of exposures presented as percentage of GDP for each year covered
- Budget horizon expanded to cover 10 fiscal years
- President shall include in the budget a statement of the President's budgetary goals for a 10-year period in terms of surplus or deficit and in terms of surplus or deficit as a percentage of GDP

Summary Financial Report for the General Public

- Pursuant to OMB form and content guidance, Treasury shall annually publish a summary financial report on the U.S. Government derived from the information in the audited annual Consolidated Financial Statements of the U.S. Government.
  - Report shall be in format and of length, content and sophistication for general American public
  - Report shall include condensed summary of CG's audit report on the CFS
- First annual report due no later than January 30, 2008 [Note: This requires an amendment to GMRA (31 USC 331(e)(1)) to make audited CFS due by January 15 each year and an amendment to the Accountability for Tax Dollars Act (31 USC 3515(a)) to make agency financial statements due by November 30 each year.]

Statement of Fiscal Sustainability

- Pursuant to OMB form and content guidance, Treasury to prepare and make public every four years an assessment of the long-term sustainability of all major federal programs and activities. Statement of Fiscal Sustainability shall include:

- PV of projected receipts and outlays of federal programs and activities for 75-year and infinite horizons, including separate reporting for social insurance programs
- Statement of annual cash flows for programs and activities
- Reconciliation of changes from prior period Statement
- Presentation of information using different measures of sustainability and estimates of financial burden on different age cohorts and other demographics
- Explanation of assumptions used and sensitivity analyses
- First Statement of Fiscal Sustainability due no later than March 31, 2008

Additional Cost Information on Legislative Proposals before Adoption

- Before a Member of the House or Senate calls up for consideration on the floor of either House a bill or joint resolution or an amendment thereto that contains a proposal that would result in a significant increase or decrease in revenues or in mandatory spending, that Member shall obtain from CBO a statement of the long-term costs of such bill, joint resolution, or amendment.
  - CBO and Budget committees to jointly define "significant" for each Congress
  - "Long-term costs" are those financial costs over at least a 40-year period
- The statement from CBO shall be provided to the Members of either House, as applicable, and shall be published in the Congressional Record

GAO Report on the Financial Condition of the U.S. Government

- The Comptroller General shall annually report to the Congress his assessment of the financial condition of the U.S. Government. Report shall include analyses of—
  - the Consolidated Financial Statement (CFS) and the Summary Financial Report
  - results of GAO's latest long-term fiscal simulations
  - the President's Statement of Fiscal Exposures
  - the adequacy of information regarding long-term cost implications of existing and proposed policies
  - the Statement of Fiscal Sustainability
  - statutorily-required CBO and JCT reports for the prior fiscal year
- First annual report due no later than January 31, 2009

Chairman SPRATT. In light of the fact that Mr. Cooper and Mr. Moore and Mr. Boyd have a bill and I believe Mr. Berry is also a cosponsor, I would like to turn first to them. I will be the clean-up hitter today and put my questions off until last and let Mr. Cooper lead the questions and make any opening statement he cares to make about their legislation.

Mr. COOPER. Thank you so much, Mr. Chairman, for holding this important hearing. We Blue Dogs strongly believe that statutory PAYGO is necessary.

We appreciate the fact that we have rules-based PAYGO today in the House and the Senate, but we would like to go that extra step, so I want to pay particular tribute not only to the lead sponsor of the bill, Baron Hill, but also to the Blue Dog leadership, much of whom are present here today, our leader, Allen Boyd; our policy Chairman, Dennis Moore; Marion Berry, an invaluable voice on all subjects.

But we want to make sure that people on the Committee realize this is open to all to cosponsor and help. We would particularly invite our friends across the aisle.

I need not remind you that statutory PAYGO was put in place in the Administration of the first President Bush. It worked well for twelve years until it was allowed to expire. And none other than Alan Greenspan has testified before this Committee that it would be the single most important reform that we could undertake to renew statutory PAYGO.

It is not perfect. Several of the flaws have been pointed out. Our excellent witnesses have done that as have folks like Paul Ryan on the other side of the aisle. But it is one of the best places we can possibly start.

I hope that we can move forward together and heed the dire warnings of the panelists. Sometimes in a hearing like this, it is tempting to just assume it is the same old, same old, but they have talked about some of the most grave threats that have ever faced the United States of America.

I would like to particularly invite my colleagues to welcome the fiscal wake-up tour led by Comptroller General Walker to your district. They came to Nashville, Tennessee last week. They have had an astonishing effect on educating and informing the people of our area on the real fiscal problems that our nation faces.

I see Bob Bixby back there with the Concord Coalition. Heritage was represented, the Brookings Institute. It is an amazing transformative effect on your district. So please take advantage of it.

I would like to end by focusing on the fact that every day in this job, we face challenges. We faced one with the Ag Bill. I hope that we will heed on a bipartisan basis the warning that Paul Ryan gave us when he pointed out that the bill may well be $5.7 billion short. So we face a moral test to how we are going to meet that.

Do we put the interest of America first or of a particular industry? And I would be the first to rant it is a vitally important industry for our nation, but America is even more important and we will face that challenge just in the next 24, 48 hours.

So there is no point in partisanship here. There is no point in finger pointing. We all have to work on this together for every bill to pull America out of the ditch. So I would like to thank the witnesses and particularly thank the Blue Dogs for their remarkable record of fiscal leadership. We can do better. We all can do better, but statutory PAYGO is a great place to start.

Thank you, Mr. Chairman.

Chairman SPRATT. Thank you, Mr. Cooper.

Mr. Ryan.

Mr. RYAN. Let me just pick up where my friend left off. Look, when Republicans had the Majority, we did timing shifts, too, and a lot of us decried them. So I am not trying to sit here and say that, you know, we are so much better than you guys are.

Congress has fallen down on the job on all of these things. But since each of us are going to have to take this vote probably Friday, I think, on final passage on the Farm Bill, Dr. Orszag, I want to go through this with you.

I have seen timing shifts in the appropriation bills that, you know, rank up in the millions, but it seems to me the timing shift in this bill is about 4.7 billion, about 5.7 total.

You sent a letter to us about the size of these timing shifts. Could you go through the offsets that are really just timing shifts in this bill and the direct scoring that are in the Farm Bill and give us a sense of what I tried to get through in my opening statement about the Farm Bill?

I mean, the whole point of the question here is, yes, we have PAYGO and you can comply with it on paper technically speaking or you can really comply with it in spirit and actually reduce spending to pay for priorities.

And I want to get to whether or not that is being the case here with the bill we are all going to vote on in a day or two. And could you elaborate on that, please?

Mr. ORSZAG. Sure. CBO estimates that roughly $4.7 billion is shifted out of the budget window through 2017 through changes in advanced payments on various different farm programs and through speeding up the collection of funds that would otherwise be collected after 2017. So that $4.7 billion number that you cited is consistent with and I am sure based on CBO analysis.

In addition to that, there is an estimated $375 million that would be collected from efforts to detect fraud in crop insurance programs. Traditionally under score keeping rule 14, those savings would not be scored. But after consultation with the House Budget Committee, we were directed to include those savings in the CBO estimate that you have received.

Mr. RYAN. Well, let me move on to that and look at some of the other bills that are coming down the pike. For example, the Student Loan Bill, that already passed. That reduced interest rates on loan but only temporarily. After four and a half years, they would return to their current level allowing Congress to basically say on paper that the bill was offset when in reality, the cost would skyrocket and the offsets would not equal their interest deductions if they were made permanent.

I think we have a similar instance in the SCHIP Bill that passed the Senate. Did that bill not show a rapid decline in SCHIP funding and eligibility for children in the out years to show that it would comply within their budget window?

Mr. ORSZAG. Yes. The funding in the back five years is significantly reduced relative to the front five.

Mr. RYAN. And so the policy assumption in that SCHIP Bill is that we are going to kick all these children off of health insurance in the last five years, in the second five-year window; is that correct?

Mr. ORSZAG. The Senate finance mark involves significantly lower funding than a continuation of the first five years would imply.

Chairman SPRATT. Let me just make clear. You said the Senate?

Mr. ORSZAG. Yes, I did.

Chairman SPRATT. Okay.

Mr. RYAN. So we can all comply with PAYGO on paper technically speaking, but the question is, are we actually really doing it? And I think the question goes to statutorily. We have a difference of opinion on how exactly to do that. But is it true that if you put a mandatory program increase in an appropriations bill that PAYGO does not apply to that?

Mr. ORSZAG. This has been the subject of some discussion. My understanding at this point is that a CHIMP, that is a change in a mandatory program on an appropriations bill—yeah, I had to learn all this kind of lingo—is now supposed to be offset, but there is some ambiguity about the handling of that kind of situation.

Mr. RYAN. Was it offset in the Iraq War Supplemental Bill?

Mr. ORSZAG. I will have to get back to you with the details of that, that supplemental in particular.

Mr. RYAN. Sure.

General Walker.

Mr. WALKER. Mr. Ryan, let me just note that when you are talking about PAYGO provisions, especially if you are talking about statutory provisions, one of the questions you have to address is who is going to blow the whistle when people may be complying in form but not substance. This is a very, very important point and I think that you really need to consider that. Who is in a position to blow the whistle and that is something that I think you need to focus on.

Mr. RYAN. I thank you. That is kind of what we are trying to do here right now.

There are many questions. I am trying to comply with the five-minute rule here, so I assume I have used all that up. So I will yield. Thank you.

Chairman SPRATT. Mr. Edwards.

Mr. EDWARDS. Mr. Chairman, thank you very much.

Let me first begin by responding as I have in the past to some of the comments made by my colleague, Mr. Ryan. He said the Democratic budget is, quote, a disappointment. Let me say what I think was a disappointment to the American people was a partisan Republican plan, budget plan for twelve years in which the Republicans controlled this House, that once combined with a Republican in the White House resulted in a free lunch philosophy of tax cuts that resulted in taking the largest surpluses in American history and turning them into the largest deficits in American history.

I would also point out that it was his colleagues in this House, not Democrats, who passed the largest increase in the Medicare entitlement program in the history of Medicare. Those votes coming from the same folks now who are telling us how we should reform entitlement spending and keep it under control.

Mr. RYAN. Would the gentleman care to yield on that point?

Mr. EDWARDS. I will be happy to discuss it if I have time at the end of my comments. The gentleman has had quite a bit of time to discuss.

He then, I thought it was interesting, criticized the Democratic plan for temporarily trying to help students get lower cost on student loans. If that is a gimmick, then I would suggest the trillion dollar tax cuts that were written purposely to be temporary must be the mother of all gimmicks. So I hope we would at least be consistent in our definition of what a gimmick is.

And then, finally, he said let us get back to working together and I do welcome that. I would genuinely welcome that. But for the facts and the record, let me point out that for twelve years, Republican control in the House, Republican budgets were passed on an overwhelmingly partisan basis with very little, if any, input from Democrats in the Congress.

So the implication that let us get back to the way it used to be, it sure was not that way during the twelve years of Republican control. If we can find common ground now on entitlement reform or other things, Mr. Ryan, I would welcome that.

Dr. Orszag, let me ask you a question. In your judgment based on your analysis, had it not been for the tax cuts passed during the Bush Administration, would we have a federal balanced budget in fiscal year 2007?

Mr. ORSZAG. Mr. Edwards, we responded to a letter from Mr. Spratt on that question and noted that there are no current estimates of the revenue impact from the tax legislation. However, if you combined original Joint Committee on Taxation scores for that revenue legislation with an estimated macroeconomic impact from a variety of models, one gets a budgetary impact on the range of about $200 billion which is slightly higher than what we expect the budget deficit to be this year.

Mr. EDWARDS. So if I could summarize that, basically that analysis making the assumptions you make says that if it were not for the Republican tax cuts that were passed without Pay As You Go, more or less under the free lunch rule, passed tax cuts and we do not have to pay for them, if it had not been for those tax cuts, we would have a balanced budget today.

The real debate on the PAYGO is that Republicans, some of them in Congress, not so much in the hinterlands of our country, Republicans in Congress are saying Pay As You Go should only apply to spending, not to tax cuts. They seem to imply that somebody can cut taxes dramatically and not have an impact on the deficit which factually is dead wrong and history has certainly proven that in the 1980s and again in this decade.

Dr. Orszag, may I ask you specifically if you cut taxes by one dollar on the American people, is there any credible evidence to suggest that you bring in an extra dollar in federal revenue to make up for that tax cut?

Mr. ORSZAG. No. There is evidence that you offset perhaps some of the costs. It depends exactly what kind of tax cut it is and it depends on how it is financed. But a full offset, that is the notion that tax cuts pay for themselves, is not supported by serious analytical work.

Mr. EDWARDS. Not supported by serious analytical work. Thank you for that.

In fact, I think some CBO serious analytical work said in some cases, tax cuts at the very best, most optimistic assumption might bring back 20 to 25 cents for every dollar lost in revenue.

And it actually went further to say that when tax cuts, as these Republican tax cuts have been paid for by borrowing money from the Chinese and Japanese and other foreign countries, that actually tax cuts actually harm the economy and reduce federal revenues.

Is that not correct that the CBO has said that tax cuts in some cases when paid for by borrowed money could actually hurt the economy and economic growth?

Mr. ORSZAG. That is correct, but that is also a reflection of a variety of studies, not just CBO's own studies.

Mr. EDWARDS. Thank you very much.

Chairman SPRATT. Mr. Conaway.

Mr. CONAWAY. I thank the Chairman for this.

I am now in my third year on this Committee and certain scripts never change. And, you know, it is both sides. There seems to be a whole lot more interest in whacking each other over things that are in the past and really we cannot go back and unwind or change. But, yet, we seem to enjoy and revel in that, but it seems to be counterproductive.

Back on the tax cuts, is there a top rate of tax that we could say does begin to become counterproductive? In other words, those charts show basically 20 percent of GDP as a constant. Can we, in fact, raise taxes and continue to enjoy standards of living increases and opportunities at a 50 percent of GDP number? Either guy, David or Peter.

Mr. WALKER. That would have serious adverse consequences on economic growth, on disposable income, on our competitiveness from a global standpoint. I think, you know, the message is clear and compelling. The math does not come close to working.

We are going to have to have additional revenues, about 18.4 percent of GDP over the longer term. The sooner that Congress acts, the lower the level of taxation can be. You are going to get the most out of entitlement reform. You are going to get something out of imposing these budget controls and reprioritizing discretionary spending, but you are going to have to get more than 18.4 percent of GDP.

And, frankly, what is going on right now is taxation without representation. What is going on right now is we are deferring huge tax increases absent meaningful reforms that our grand kids——

Mr. CONAWAY. Let me challenge you a little bit there. So the only way to fix this wreck is to raise taxes to 50 percent?

Mr. WALKER. No. Absolutely not. Let me be clear. I think there is a multi-pronged approach. One, reimpose tough and meaningful budget controls including statutory PAYGO rules that apply on both sides of the ledger to slow the bleeding or stop the bleeding.

Secondly, to reprioritize the base of discretionary spending, a lot of which is not very effective.

Thirdly, reform entitlement programs and, fourthly, engage in tax reform, all those.

Mr. ORSZAG. And if I can just add, I think in addition to PAYGO rules to avoiding making the problem worse, by far the most important thing to start tackling is the rate at which healthcare costs grow, period. And we are not investing enough in analyzing options and exploring policy choices that will help bend that curve.

If there is anything else that we could possibly do during your time in Congress, during my tenure at CBO, if we start to bend that curve, we are going to leave future generations substantially better off than anything else that we could do.

Mr. CONAWAY. And is there a way to raise taxes to do that, to fix that?

Mr. ORSZAG. It is clear that we are on a path that ultimately——

Mr. CONAWAY. No, no, no. Can you fix healthcare costs curve by raising taxes? No. What you have to do——

Mr. ORSZAG. That is on the spending side.

Mr. CONAWAY. I understand that. But every solution coming from many of our folks is that let us just raise taxes, let us just raise taxes. And I want to challenge that.

You have just said that that is a spending issue. Healthcare costs is a spending issue and so we have to deal meaningfully with the rate of growth of those costs and that spending in order to make this work.

This is not a hundred percent guarantee either way. I mean, neither side has the answer. We cannot cut spending enough to do it and you guys cannot raise taxes enough to do it. And so we have got to figure out some way to make it work.

Mr. WALKER. The President did put something on the table that I do not think the Congress took seriously enough, quite frankly. There is no way you can solve this problem with taxes alone. That would be counterproductive. All right?

But the President put two things on the table in his last budget submission that relate to revenues, that relate to healthcare. First, that we need to change the tax treatment of the fact that most individuals do not pay income tax or payroll tax on employer-provided and paid healthcare. Number one tax preference growing very rapidly.

And, secondly, we need to look at whether or not the subsidies for Medicare, whether or not well-off individuals ought to be paying more for Medicare than they are right now. I think it is inevitable we are going to have to do those two things. You need to do a lot more than that to get the cost curve under control. It is inevitable you are going to have to do that.

Mr. CONAWAY. Let me ask one quick one, David. You mentioned who is the whistle blower in this deal. Would enhanced recision be helpful or is that just a figment of all of our imagination?

Mr. WALKER. I think there is a middle ground. You know, obviously line item veto is, you know, a problem from a constitutional standpoint because of the change in power. However, expedited line item recision that only requires a majority vote by the Congress to override, I think, has potential and should be seriously considered.

Chairman SPRATT. Mr. Doggett of Texas.

Mr. DOGGETT. Thank you very much.

Dr. Walker, you indicated in your testimony that as bad as things are right now, it was not that long ago when they were significantly better. I believe your testimony was that in January of '01 when you testified, and which I think happened to coincide with President Bush taking the oath of office, that we had fiscal sustainability for 40 years; is that correct?

Mr. WALKER. That is correct.

Mr. DOGGETT. And you said for a variety of reasons, we have changed that. I took Mr. Ryan's statement to be essentially that since that time, Republicans have dug us into such a budget hole that statutory PAYGO alone will not solve the problem and I agree with him. I think we need that and we need more.

The suggestion by Mr. Conaway that we cannot go back and undo all that has been done and that this is all in the past is true to a point. It is just that some of that thinking from the past continues to persist today that we can continue to cut taxes and even though the studies are widespread that that will not generate more revenue than it costs us, that we can continue to do that.

I am interested particularly, since I serve on the Ways and Means Committee, in the comments that you mentioned about tax preferences is back-door spending because they are not only back-door spending, but they are usually a very blunt instrument to accomplish what they are set out to do. And I have supported many of them and I have questioned many of them.

But if you take something like how to address the problem of uninsured children—my State, as you know, Dr. Walker, is right at the top in not caring for its children and providing them access to healthcare. And the suggestion that you can cover more of them with a tax credit, but it is a very inefficient and cost ineffective way to try to get more poor children of the working poor covered versus dealing with it with a direct expenditure.

There has been a tendency in recent years with all the hullabaloo over tax cuts as a solution to every problem to think that if you can cut taxes for them enough that you can solve that and any other problem.

What do you think is the most effective way to address the problem of the 800 to 900 billion that you say we are losing in revenue through tax preferences, back-door spending? Both of you, I would welcome your comments.

Mr. WALKER. We have a number of recommendations in that transparency in accounting and budgeting proposal that I mentioned before which is a beginning and we are engaging in discussions with CBO and OMB and a number of members on the Hill on that.

Part of it is that we need to have more transparency over this. For example, we ought to have included in the financial statements of the government, we ought to have it included in budget documents how much money we are talking about. What are these, how much do they cost us. We ought to have a mechanism to try to periodically reevaluate these preferences to understand whether or not they are making a difference or not and who is benefitting from them.

And let me give you a perfect example. We spend a lot of money on tax preferences for savings. Most of them do not work. America has a negative savings rate.

Mr. DOGGETT. Are we not spending more money on retirement tax credits than we get in retirement savings from those credits?

Mr. WALKER. I cannot talk at that level because you are talking about a subset of overall savings. What I can tell you is, and part as you know for retirement savings, that is a timing difference. You do recapture revenues in the future when people end up getting their payments out. So it is a little bit more complicated than that.

But what we do know is we spend a lot of money on current tax preferences, but the household savings rate in America for the last two years was negative.

Mr. DOGGETT. Dr. Orszag.

Mr. ORSZAG. Let me make a couple comments. First, there are a variety of tax expenditures that are devoted to policy objectives that seem inconsistent with other things that the Congress is simultaneously trying to do. So that is one set of issues that may warrant attention.

Even for those that are aimed at objectives that the Congress seems dedicated to, promoting retirement saving, promoting health insurance, et cetera, the current design has several inefficiencies associated with it. Most prominently, tax expenditures are provided in the form of a deduction or exclusion and that means that for a lot of tax filing units that do not owe income taxes, they are not of any benefit.

And from a narrow economic efficiency perspective, if you are going to be providing an incentive for health insurance or retirement, unless you know that high-income households are more responsive to that incentive or generate larger benefits when they do respond, it does not make sense from a narrow economic efficiency perspective to have anything other than basically a flat incentive.

Mr. DOGGETT. Mr. Chairman, may I just ask one other follow-up on this?

Dr. Walker, you told Mr. Ryan that the big question was who will blow the whistle to ensure PAYGO is enforced. Who do you think should blow the whistle? How should it be done?

Mr. WALKER. Well, it depends. One, I do not want to compete with CBO and there are a number of things that CBO has the ability to do right now within its authority and you could give them more authority potentially.

But I did hear one word that Peter mentioned. He said he was directed, CBO was directed to do certain things. I think, you know, one of the things you have to think about is that you have to make sure that, depending on how this is structured, that you have parties that are independent of the process and that are not subject to being directed because in the analysis, Peter is exactly right. It is not just a matter of whether or not it complies in form. It is a matter of whether it complies in substance. And that involves taking some risk. You know, a lot of times, people do not want to hear that it is okay in form but not in substance.

Chairman SPRATT. Let me clarify what directed means. In every case where CBO was called to give us their judgment as to potential savings from potential proposals, we asked them only to include the savings in the baseline when they themselves determined that those savings could be validated.

For example, the USDA presented in its budget request an estimation that data mining and other fiscal disciplines applying to crop insurance would yield as much as $650 million in savings over a period of five years. That would have helped greatly in meeting our PAYGO requirements for the Farm Bill at that point in time. The CBO would only score it at $125 million.

There were other issues that I could go through. But in every case where they gave us a number that they thought was a valid savings number, then we, when necessary, asked or directed that it be included, but we did not direct them to do anything that they did not determine themselves. I can see how the word directed would give rise to that, but that is the way the processes work.

Mr. ORSZAG. Mr. Chairman, if I could just add one further comment along that note. On score keeping rule 14 and other rules governing, rule 14 and rule 3 in particular, there are questions that I know that the Budget Committee may want to revisit and that CBO could help the Committee revisit in terms of the operation of those rules.

So the most immediate example that was presented involved a rule that to many budget observers has some shortcomings associated with it.

Chairman SPRATT. Thank you.

We will now turn to Mr. Alexander of Louisiana. Okay.

Mr. Smith of Nebraska. Not here.

Mr. Campbell of California.

Mr. CAMPBELL. Thank you, Mr. Chairman.

A couple of things about which there appears to be no dispute. One is that we have a big problem with entitlement spending, that that is the biggest long-term problem that we face and we have to do something about it or we will have the fiscal train wreck, crash, explosion, whatever it was you called it, Mr. Comptroller General, and that PAYGO statutory or rules based is not going to cure that because it simply, as you said, stops you digging the hole, but does not get you out of the hole.

Given those facts and the purpose of the PAYGO or any PAYGO like this is to set a structure that prevents us, Congress, from creating more deficit. Given all those facts, does it not make sense or what are your thoughts on that PAYGO, if it is an inaccurate structure, that we look at an adequate structure to deal with this thing over the long term, something like a spending limit because if we continue to increase spending at or above the growth of economy, we will never do anything but increase our deficit unless we perpetually increase taxes?

But if we hold spending long term below the growth in the economy or even at the growth in the economy or even marginally above the growth in the economy, that we will eventually get around this thing and would that not create a structure that would require us, which, frankly, we are going to need to do, require ourselves to make the tough decisions that will get us out of this hole? And I ask that for both of you.

Mr. ORSZAG. I guess I have some concerns or reservations about that approach as opposed to one that tackles the underlining drivers of the costs themselves. So in other examples, you know, for physician payments, the Congress tried to set an overall cap, the sustainable growth rate formula. What happened was, because you did not then tackle the underlining driver of the cost affecting physicians, every year, the cap gets lifted. I think it would be much better to spend time again investing in figuring out what is going to help bend those curves than trying to somehow artificially put a cap on top of it.

Mr. CAMPBELL. Dr. Orszag, if I may, the idea is that, yes, I absolutely agree with you. You have to deal with some of these fundamental things. But these are tough things for us to deal with, for political bodies to do.

And what we need is the external discipline. I often use as an example that people know they should save for their retirement, but it is hard to do. There is stuff you want to spend on it now.

So what do you do? You have your employer take it out of your paycheck so you never have the opportunity to see it. You need that external discipline to do what you know is right.

And what I am suggesting and what you are saying, Dr. Orszag, is that these are things we know are right, that an overall mandatory and discretionary spending limit would force us to do those things.

Mr. WALKER. Let me come back. First, the real problem is mandatory spending and you need to figure out a way to be able to periodically reconsider those. They are on auto pilot right now. They continue to grow. They are outside the budget process, et cetera.

One way you could do it is to put a hard cap on. Another way you could do it is to say we are going to have periodic reconsideration and there may be certain things that were going to happen no matter based on the passage of time.

And if certain triggers are hit with regard to total spending, we might accelerate that reconsideration because things were going worse than we thought that forces reconsideration at least. And you may or may not pass legislation, but it forces it.

Now, on a cap, I personally believe that in the long term to solve our healthcare problem, we are going to have to do four things.

One, figure out a way to provide basic and essential healthcare services to everybody. Basic and essential, I choose those words carefully.

Secondly, impose a cap on healthcare spending by the federal government.

Mr. CAMPBELL. Aren't those two things in conflict?

Mr. WALKER. No. No. Absolutely not. We could provide basic and essential cheaper than what we are doing now, all right, over the longer term.

A cap on what the federal government spends because only the federal government can print money and mortgage the future of the country with impunity as of present point in time.

And, thirdly, to move to evidence-based quality standards and, fourthly, to improve personal responsibility and accountability.

So I think there is a role for caps in certain regards, but I think there is a lot of things that you can do in the interim before you get to that.

Mr. CAMPBELL. Dr. Orszag, in my final ten seconds, anything else you have to say on the idea of a spending limit?

Mr. ORSZAG. I think the history of imposing strict limits, whether it is on the deficit under the predecessor to the "Budget Enforcement Act" or under the sustainable growth rate formula, just imposing sort of a blunt cap tends to simply engender efforts to get around it. And it would be better to get at the underlining drivers of the cost, not that it would necessarily be harmful, but it is not particularly productive.

Chairman SPRATT. Mr. Berry.

Mr. CAMPBELL. I yield back. Thank you.

Mr. BERRY. Thank you, Mr. Chairman, and thank you for holding this hearing. I thank you all for being here.

General Walker, we certainly appreciate you and the message you have carried across the country to try to convince as many people as possible that we cannot keep doing what we are doing and we are going to have to change our ways. That is my simple way of describing what I think you have been doing and I applaud your effort for doing that.

I am curious as to how that is received. When I try to do that, the Rotary Club does not like it and then they would just rather not hear about it. And I am curious as to how you have been received around the country. I know you have gotten some good Editorial Board reviews and things like that.

Mr. WALKER. So far, we have been to 21 states, plus the District of Columbia. By the end of this year, we will be to at least half the states in the union and have other ones scheduled after that.

Initially the reaction that we got was people were shocked and appalled as to what the situation was. They had no idea that it was as bad as it was. Now what we are seeing is more people are aware that we have a serious problem and it is getting worse with the passage of time. And now they are saying what are we going to do about it. I mean, what is a possible way forward, if you will.

You know, candidly what we are trying to do, meaning the participants in the official wake-up tour, Concord, Brookings, Heritage, and myself, are trying to make sure that the next President, whomever he or she might be, no matter which party they might be affiliated with, makes fiscal responsibility and intergenerational equity one of their top three priorities. And my personal view is if they do not, we are in trouble.

And by the way, healthcare is a big subset of that. I mean, healthcare is the biggest driver. It is not the only one, but it is by far the biggest one.

Mr. BERRY. It has been said here this morning and I have heard it said many other times in some cases, you know, nobody has the answer. I refuse to believe that. I came here in 1993 and worked in the Clinton White House. If I am not mistaken, Peter, you were there too.

Mr. ORSZAG. I was.

Mr. BERRY. And my response to that is we did it. I do not know if our situation then is as bad as it is now, but it was pretty doggone bad and we cut 20 percent of the federal workforce and we made some really tough decisions. And I refuse to believe that we cannot only cut spending, get control of healthcare costs, and provide better healthcare for the American people all at the same time.

So, you know, I think that this is a doable deal. I think it is something we have to do. And I applaud both of you for addressing this. I think PAYGO is good. I support it. And at the same time, I hold no illusions that that solves all our problems.

We have got a lot of tough decisions to make, but we are going to have to make them and make them soon, at least that is my opinion. I am not asking you to associate yourselves with that remark. You will get in enough trouble along the line without having to associate yourself with me.

But I thank you for being here and I appreciate the work that you do.

Mr. WALKER. If I could mention real quickly, Mr. Berry, PAYGO is definitely something that in my view should be adopted on both sides of the ledger. It is not a panacea, but it does not do anything by itself to deal with the $50 trillion hole that we are in. And so while it would help us, we have got to focus on that 50 trillion of which 32 trillion plus is Medicare alone.

Mr. BERRY. Well, the only time I do not like PAYGO is when they score my bills too high.

Mr. ORSZAG. Yes. I have been experiencing a lot of this sort of cognitive dissonance over scoring.

Chairman SPRATT. Mr. Tiberi.

Mr. TIBERI. Thank you, Mr. Chairman, for having this hearing.

And thank you, Mr. Walker, for what you are doing around the country. You came to central Ohio earlier this year and my dad was quite impressed with your presentation. My dad and mom came to America for a better life, for the hope and promise of the American dream. My dad did not have a credit card until he was 60 years old. He is still living in good health and retired today.

And he was a big fan of a guy whose portrait is in this room, John Casik, a former Chairman of this Committee, who talked a little bit about fiscal discipline when he was a member of Congress.

And what my dad does not understand from his—my dad is a Reagan Democrat, I guess. He does not understand all the talk above the room up here when we talk about spending in Washington, D.C. And let me give you an example, Mr. Walker, that I would like you to comment on.

PAYGO, my dad is for PAYGO. You pay as you go literally, everything, everything. You pay as you go in a household. And he was shocked to find out this year, this year when I gave a speech somewhere and said that the Democrat budget provides for $81 billion over last year of discretionary spending, over last year, $6 billion in an omnibus, $17 billion in nonwar emergency spending, all not subject to PAYGO. He scratched his head and he said, well, that is not PAYGO. That is fake PAYGO. I do not understand that.

And it is something that I have talked about at meetings as well. In the context of this large debate, we often hear here that keeping more of your own money is a bad thing.

At the same time, when you have every year, literally every year, we spend more than the previous year as a government. Government is set up to spend more money. And if we try to slow the growth of government, not cut it, but just slow the growth of government, that is always a bad thing.

So in the context of your message long term, if we have a PAYGO system in place, would not the best type of PAYGO system be one that former Chairman Casik advocated and the fact that it would be one that applies to discretionary spending, which this one does not, discretionary caps, which this does not, emergency spending that cannot be simply avoided with a point of order.

Bottom line, PAYGO applies to everything because as you have said better than anybody out on the talking circuit, the thing that is really going to kill us is not the $81 billion over last year in discretionary spending even though to my dad, that seems like a lot of money. It is the mandatory spending that is on auto pilot.

And the budget that this Committee adopted earlier this year does nothing with respect to the mandatory spending that is on auto pilot with respect to reconciliation of what you pointed out were the healthcare costs.

Is that not truly something that we should more focus on rather than have this talk about, what, you know, some have talked about in the halls outside of this room is that you are going to have to double the tax that—you have not said this—double the taxation that Americans pay for my daughter to make sure that she has healthcare, Medicare, and Social Security when she is ready to retire?

Mr. WALKER. Well, several things. First, you know, clearly there are debates from time to time about what are true emergencies and, therefore, might not be subject to the rules.

I understand your point that the PAYGO only applies to discretionary and that discretionary is not the major part of the problem. The major part of the problem is mandatory.

Mr. TIBERI. It does not apply to discretionary. It only applies to new mandatory; is that correct, Mr. Chairman?

Mr. WALKER. Right. In other words, what you are proposing is we also need spending caps in addition to PAYGO, but you are talking about a spending cap that is beyond just discretionary is what I hear you saying.

Mr. TIBERI. For everything.

Mr. WALKER. Yeah. I understand what you are saying. Let me tell you one of the concerns that I have about that. I think that we need to do better than PAYGO on everything and the reason I say that is that back-loads action. We need to reform Social Security and Medicare now. All right?

And what I am concerned about is I do not want to give a false sense of security that if we achieve PAYGO on the short term on those programs that we do not have a problem that we need to solve because in reality, the $50 trillion hole that we are in goes up two to three trillion minimum every year due to the passage of time because of demographics, healthcare costs, compounding interest, et cetera.

And so, you know, my view is that we need to reimpose tough budget controls of which PAYGO is one, tougher than we had in the early 1990s because we are in worse shape in the longer term, and we need to start engaging in reexamining tax preferences and entitlement and other mandatory spending. We need to start now and I do not know that we do it on a max PAYGO rule.

Mr. TIBERI. Thank you.

Chairman SPRATT. Let us bear in mind that the next year, the increase in the base defense budget is at 48 to $50 billion and the supplemental increase which is included with the fiscal year 2008 defense budget is $142 billion additional.

If you add a cap on discretionary spending, you would still have to accommodate that or begin to truncate spending substantially for Iraq and Afghanistan.

Mr. Boyd.

Mr. BOYD. Thank you very much, Mr. Chairman. And first I want to start by thanking you and, of course, Mr. Ryan for accommodating this hearing. We think it is very important.

And I also want to thank Director Orszag and General Walker. You guys are great. General Walker, there is nobody with a louder bullhorn on these issues than you in the last number of years. And we are very grateful to you.

Mr. Chairman, I have been listening with a great deal of interest and I hear some things that I like. I hear a few things I do not like. But I want to first start by applauding Paul Ryan not for all that he said but certainly the way he wound up.

And you said let us get back to working together, and echo the comments of Mr. Conaway, too, and I do this an effort to show you that there are people in this room that want to work in a bipartisan way.

As I remind you that the first PAYGO measure was passed by a Democratic Congress and signed into law by a Republican President, George Herbert Walker Bush, in 1990. Democratic Congress, Republican President.

It was extended in the 1990s by a Republican Congress, in 1997, I think it was, and signed into law by a Democratic President, Bill Clinton.

In April 2001, President Bush declared his support for two-sided PAYGO in his fiscal 2002 budget request to Congress.

Now, there are many in this Congress, Mr. Chairman, who would prefer a one-sided PAYGO. Some would want PAYGO to only apply to taxes and not to spending. Others would want it to only apply to spending and not taxes. But the only way PAYGO works, as these gentlemen will tell you, is to have it two-sided.

I have heard a lot about what has happened in the last few months about budgeting, timing shifts, expiration of policies before the budget window is completed so that you do not break the bank or exceed spending limits. I have heard a lot about CIMPs.

I want to tell you, Mr. Chairman, the last six years, most of all of those gimmicks have been used up. There are not many left to use.

So my plea to you before my question is that we do need to work together, Mr. Ryan, Mr. Conaway, and others. And if we are going to get this done, the only way we are going to get it done is working together.

Mandatory spending has to be dealt with. These gentlemen, everybody here knows that.

Mr. Tiberi, I would remind you that all the things that you said are so important. We had it in the statute until 2002 when they expired. I do not need to remind you about the details of how that happened, who let it happen.

So my question simply is this to the gentlemen at the table. This is a complicated issue. It is politics wrapped all around it, partisan politics. Is PAYGO, statutory PAYGO a good start for getting us back on to a path of fiscal sanity?

Mr. ORSZAG. PAYGO helps to avoid fiscal deterioration and statutory PAYGO opens up possibilities that a rules-based PAYGO does not have, like sequestration, for example.

Mr. BOYD. Including discretionary spending caps and statutory PAYGO?

Mr. ORSZAG. You could incorporate discretionary spending caps into a PAYGO system broadly like the "Budget Enforcement Act" did.

Mr. WALKER. Yes, it is a good start, but it is just a start. We need to do more.

Mr. BOYD. Thank you, Mr. Chairman. I yield back the balance of my time.

Chairman SPRATT. Thank you, Mr. Boyd.

Mr. Porter.

Mr. PORTER. Thank you, Mr. Chairman.

And, gentleman, appreciate your testimony. And not to belabor this point, but appreciate but what you are both doing very, very much.

General, you mentioned in the four steps of success of healthcare and one of those was figuring coverage of basic and central for everyone. Can you expand upon that for a moment, please?

Mr. WALKER. Yes. I will give you one potential conceptual framework. If you look at what are basic and essential services that people need versus unlimited healthcare that people want, especially if somebody else is willing to pay for it, then I think you can find that there are certain key elements.

First, inoculations against infectious diseases, certain wellness services that make sense not only individually but also collectively for society.

Secondly, protection against financial ruin due to unexpected catastrophic illness. Financial ruin varies based upon your means and catastrophic illness obviously is unexpected, could occur at any time during your life, while avoiding heroic measures. Heroic measures involve being able to just throw technology or whatever at it where there is no real meaningful chance to improve or extend the quality of life or life expectancy period.

And, thirdly, guaranteed access to additional healthcare if you want, but you will pay for it. You will pay for it either as part of your compensation through your employer or you will pay for it otherwise out of your pocket. That is the need.

There are a lot of things we are doing right now that go well beyond need and we do not have adequate incentives, transparency, and accountability mechanisms to control cost. And we need to recognize that reality.

Mr. PORTER. So the basic and essentials, and I think I follow what you are saying, how should that be provided?

Mr. WALKER. One possible way to provide that is recognize that the largest risk pool and financing mechanism that exists in the country is the federal government to where ultimately you would redefine division of responsibilities for healthcare between the federal government, other levels of government, employers, and individuals, and you would have to phase into this over a number of years.

So in some cases, it would mean the federal government would be providing something to people it is not now, for example, the uninsured, but on the other hand, over time, it means we would not be providing as much as we are in certain segments of society now.

I think the last thing we need to keep in mind is there is a difference between whether or not you are covered by a program and how much you ought to pay for it. One of the things we need to be thinking more, as I mentioned to Mr. Conaway, we need to be thinking about it is one thing if you are covered by Medicare, it is another as to how much you ought to pay for it. You know, the taxpayers for Part B and Part D pay 75 percent of the cost.

Should the taxpayers subsidize, should our kids and grand kids subsidize 75 percent of the cost for everybody no matter what their means is? I would debate that.

Mr. PORTER. Thank you very much. Again, appreciate both you and what you are doing. Thank you.

Chairman SPRATT. Mr. Etheridge.

Mr. ETHERIDGE. Thank you, Mr. Chairman, and let me thank you for holding this hearing and the Ranking Member too.

You know, we can talk all day about how we got here. Most of us know what happened. And I think Mr. Boyd covered it pretty well. There were those who decided that they would rather get off of PAYGO and spend and not have to pay the bill. And then now they are the ones who want to talk about how we do it.

The truth is, I think, and I want to hear your comment, you touched on it already, I think you have covered it. You said we need PAYGO on both sides of the ledger, on the spending side as well as the tax side. And I happen to agree.

There has been a lot of comment on the Farm Bill here and let me, since I sit on that Committee, I think it is appropriate I have something to say because when that bill comes to the floor, it will be deficit neutral. We have an obligation to do that as a Committee.

And the real issues gets between the mandatory and the discretionary piece of most of these issues. And this is a five-year piece of legislation. There are those who would like to take rural America back to the wood shed for the free spending of some folks who are not a part of rural America. And if we take it out of rural America, it has been my experience over the years, if rural America falters, the rest of us follow pretty quickly behind. Our food and fiber is in trouble.

But my question to you, to both of you, and I thank you for what you are doing, and, Mr. Walker, let me thank you for taking the message across America. I think it needs a third party. We saw that in the early 1990s what happened and I think it is important we continue to do that because your leadership is so critical.

But I think it is important to get some messages out. No matter how hard we work, one individual can discredit an awful lot of what we are going to do. And let me give an example.

The Vice President of the United States said deficits do not matter. And a lot of people listened to that and they think that is really true. I happen to believe deficits matter. I think every American does. But if they think they are going to get something and it does not make any difference, and I appreciate your comments as relates to deficits in the general sense, you have touched on it, because PAYGO in light of the explosion of the foreign debt that is now flowing into this country to some extent is helping keep our interest rates down because people are investing in America.

At some point, if we do not get our house in order, that is not going to happen and we will hit the sunami of rising interest rates, the lack of investment in foreign dollars, and escalating tax increases.

I would appreciate both of your comments on that because I think that could be the worst of all worlds and we have not touched on that. We have gone around it, but we have not touched it directly.

Mr. ORSZAG. Deficits matter a lot.

Mr. Walker.

Mr. WALKER. Yeah. I will expand a little. You are correct. The Vice President did say that and the question is, what did he mean. Did he mean that they did not matter politically or did he mean that they did not matter economically? Did he mean that the deficits at the levels that we were running then were not a problem? Who knows? You will have to ask him.

Here is the bottom line.

Mr. PORTER. They both matter.

Mr. WALKER. Structural deficits matter, especially when they are large and growing. But it is not just the deficits. It is the accumulated debt and related burdens associated with those deficits.

Part of the problem we have right now is our current level of deficits are not a big problem. But what is the big problem is where we are headed. We are headed into uncharted territory.

Now, in fairness, the Administration's position on deficits has changed dramatically in the last year and a half, maybe in part due to fiscal wake-up and other efforts. I do not know. Now the President says deficits matter. We need to balance the budget within five years, although he is just talking the unified budget, not operating.

And we need to make a down payment on the $50 trillion imbalance and he proposed about $8 trillion worth of down payments in part due to the things I talked about before, changes in how we tax or how we give tax preferences for employer-provided healthcare and income-related premiums for Medicare, if you will, you know.

So we also need to keep in mind foreign debt. The biggest risk we face is that since we are relying upon foreign investors to finance our excess consumption to an extent that we have never relied upon them before, if they decide that they do not want to continue to finance our debt at the same rates that they have, interest rates will go up and when interest rates go up, that will have a compounding effect.

And, by the way, our simulations do not assume any rise in interest rates.

Chairman SPRATT. Ms. Schwartz of Pennsylvania.

Ms. SCHWARTZ. Thank you, Mr. Chairman, and appreciate the last couple of comments that were made because I would like to bring this back.

There was a lot of discussion about how we might tackle the long-term dilemma about healthcare costs and some of the mandatory programs.

But really this hearing is supposed to be about our fiscal honesty in the way we do budgeting. So I would like to bring it back to that if we can. I think the last couple speakers tried to do that.

What we are trying to do here is to make sure that we are very clear that we will not spend any money in the budget that we cannot find. And we refer to it as PAYGO, but, you know, I do not know if anybody is listening, but if anybody is listening, they may not know what that means.

I mean, simply we want to live within our means and have a balanced budget and figure out how to start paying down our debt and deal with our long-term fiscal dilemmas.

Now, the first step we are saying is that we have to recognize where we are and begin to work on the rule, under the rule, and that is what we are trying to do is to not spend any money in this next year, next five years that we cannot find. So that means that we are trying to be really fiscally disciplined when we are dealing with that.

And I am on the Ways and Means Committee, as well as on Budget, so we are given the task of finding those dollars within the budget. We are doing it under a Medicare Bill that we are going to be marking up in a couple of days to find money within Medicare, shift it around in the ways that we think will make a bigger difference.

So the question we have before us is do we set it into law, one, and, two, the other side of the aisle is saying they only want PAYGO rules. They only want to live within our means under expenditures. They do not want to count taxes so that if we cut taxes, they do not want to count.

Now, if they can be simple answers, I would appreciate that. Is it not true that our expenditures in the last six years under President Bush have gone up?

Mr. ORSZAG. Yes.

Ms. SCHWARTZ. And they have gone up even——

Mr. WALKER. Yes.

Ms. SCHWARTZ [continuing]. Past inflation?

Mr. ORSZAG. Yes.

Ms. SCHWARTZ. So when the other side says why have we not reined in our spending, we have had six years when they had a chance. They were completely in charge. President Bush, Republican House, Republican Senate, did they rein in spending? Maybe that has emotion to it and I am not supposed to do that. It did increase——

Mr. ORSZAG. Spending has increased.

Ms. SCHWARTZ. Thank you. Okay.

And in some cases, fairly significantly in discretionary funding, and I am not even talking about war funding or emergency funding? I am talking about under our budget.

Mr. ORSZAG. Nondefense discretionary spending is now higher as a share of GDP than it was in 2000.

Ms. SCHWARTZ. Right. The number I got was discretionary outlays under the current Administration over the last six years, outlay average annual rate grew by 9.4 percent. Does that sound about right?

Mr. ORSZAG. It seems plausible. I do not have the exact figure.

Ms. SCHWARTZ. Okay. And discretionary budget appropriations under again President Bush was 8.5 percent. Under President Clinton, just by example, is three percent. So that sounds about right?

Mr. WALKER. I remember some benchmark data going back to past administrations and as I recall, Lyndon Johnson's was the only Administration up until about a year ago where spending increased at a more rapid pace. But you do need to break that down between how much of it is defense versus nondefense, how much of it is structural, how much of it deals with emergencies such as the Global War on Terrorism, et cetera.

Ms. SCHWARTZ. The point I am making is that we are really trying to do it differently. We are saying that we are not going to spend money that we cannot find, that we cannot identify in another way.

But let me just say quickly, I only have a short amount of time, you have said this already, but at the same time, not only do we see an increase in spending, we did see a dramatic cut in taxes. So what that means is it is less money coming in to spend than going out and we are spending more going out, right? And that has resulted in major new debt. You have talked about that quite a bit, General Walker——

Mr. WALKER. Correct.

Ms. SCHWARTZ [continuing]. About the significant amount of money we are now spending just in interest payments on debt. So we are creating new debt. We have spent more money and we are cutting taxes.

The point we are trying to make here today, and I really just will close by asking you to agree or disagree, that if we are going to get serious going forward, that we need to apply these simple budget rules not only to spending, which we are trying to do, but also to tax policy. And if we do not do that, we will not ever be able to tackle both short-term and long-term fiscal discipline and fiscal sanity as was referred to.

Mr. ORSZAG. If the purpose of PAYGO is to avoid fiscal deterioration, there is no differentiation between mandatory spending and revenue that would seem to be justified.

Mr. WALKER. I agree. It needs to be on both sides of the ledger or else it is not going to be effective.

Ms. SCHWARTZ. Thank you.

Chairman SPRATT. Mr. Garrett.

Mr. GARRETT. Thank you, gentlemen.

First of all, with regard to your fiscal sanity tour, I welcome you to come to our great State of New Jersey who is about to start selling off assets to meet its debt and if you join us with your information that you have, it would be helpful.

Secondly, I would like to go back and compliment the words of Mr. Boyd and Mr. Ryan who outside the room saying anything we do here has to be done jointly bipartisan if we ever thought we are going to try to get this under control.

And, finally, also, I see Mr. Berry is not here right now, but to agree with him and his comment about being in the local rotary or what have you. A lot of times when you go home, the people do not want to hear some of what you are probably testifying to when you go about in the community. I can tell you not only do they not want to hear it back at home in the rotary, they do not want to hear it here as well.

My main thrust is going to be with regard to mandatory spending which is what we are here talking about today. But even trying to do the proverbial drop in the water savings, I am one of those guys who goes down to the floor every so often and tries to make a drop in a bucket savings with regard to the discretionary side on discretionary spending with earmarks or what have you.

And I am sure you follow this closely or at a distance and realize that the majority of those times, any one of those infinitesimal small percentages do not get saved as well and therein lies the dilemma on the discretionary side. The problem is even larger, of course, on the mandatory side.

And chart one just shows projected spending growth under current law. Looking at that chart, how much of that chart then comes under PAYGO right now under the current rules?

Mr. ORSZAG. None of it.

Mr. GARRETT. And so there——

Mr. ORSZAG. But discretionary is not covered by the PAYGO rule.

Mr. GARRETT. There you go. Well, how much of the—okay.

Mr. ORSZAG. The mandatory spending that you are showing there to the extent that it is the baseline spending level is not covered by PAYGO. It is only changes off of that that would be covered by PAYGO.

Mr. GARRETT. Exactly. And so as a percentage over that whole chart that we are looking at, how much is it that is really covered under current PAYGO rules then?

Mr. ORSZAG. Again, to the extent that is the baseline, it is not covered by PAYGO period.

Mr. GARRETT. Basically not. And therein lies the underlying problem that we are facing going forward in these areas. I think it was Mr. Tiberi who was making the point that we do see increases, Ms. Schwartz says as well, each year. But those increases can come even if we do not do anything, correct?

Mr. ORSZAG. Well, again, as Mr. Walker and I both emphasized, PAYGO is intended to make sure that problem does not get worse, but it does not address that problem itself.

Mr. GARRETT. Right. And it makes sure it does not get worse on new programs, but it does not do anything as far as making sure the problem does not get worse with existing mandatory programs?

Mr. ORSZAG. That is correct.

Mr. GARRETT. And so if we really want to try to get our arms around this, do we not have to go down that road and make—I think you said this, but I do not want to put words in your mouth—if we really want to get our arms around this, have PAYGO apply simply to everything?

Mr. ORSZAG. Well, that final step is one that I am not sure about. You know, it is up to the Congress to decide how you want to tackle this underlying problem.

Again, I think the key thing is to get under the hood of, in particular, baseline spending and see what is driving that and how can we take cost out, especially in healthcare, without harming health. I think there are very substantial opportunities there that are difficult to capture but that are possible to capture and having the Congress devote more attention to that issue is the best way of making sure that that——

Mr. GARRETT. Right.

Mr. ORSZAG [continuing]. Increase is leveled.

Mr. GARRETT. And I will let you answer that. And the way that Congress does that, I know we have done it in the past a little bit, is through reconciliation, right, Mr. Walker?

Mr. WALKER. Right. But what we have said is PAYGO rules on both sides of the ledger.

Mr. GARRETT. Right.

Mr. WALKER. Mandatory reconsideration triggers, so you will—it is not a cap, but forces reconsideration of mandatory spending programs and tax preferences when they reach certain triggers because you are correct. You know, the PAYGO rule by itself does not deal with the base. And the base is the problem. We want to try to stop the bleeding, but that does not solve our $50 trillion problem.

Mr. GARRETT. But for practical purposes as far as procedurally, the way we would get to that reconsideration, as you call it, is through our mechanism of reconciliation; is that correct? I mean, do we have any other——

Mr. WALKER. De facto, okay? But on your reconciliation, you are not reconciling mandatory programs.

Mr. ORSZAG. Well, you could. I mean——

Mr. WALKER. But we could.

Mr. GARRETT. I mean, you could, but you are not——

Mr. ORSZAG. In fact, that is what it is designed to do.

Mr. GARRETT. Yeah. That is what it was put there for, is it not, and that would be the only way to do what you are telling us we need to do?

Mr. WALKER. Maybe under the current procedure. I think there are other ways you could look at it going forward.

Mr. GARRETT. Thank you. Appreciate it.

Chairman SPRATT. Mr. Moore.

Let me stop here and say I know that both of you are under time constraints. And, General Walker, if you need to leave and you want to substitute one of your staff in your place.

Mr. WALKER. Thank you. I have to leave within about five, ten minutes.

Chairman SPRATT. Peter, you have got to go?

Mr. ORSZAG. I think we are okay for now. Until otherwise notified, I will remain at your disposal.

Chairman SPRATT. Okay. Mr. Moore.

Thank you.

Mr. MOORE. I apologize. I had to leave for just about half an hour, 45 minutes, so I missed this discussion. And I apologize if I am asking a question that has already been asked.

But there was an article in Congress Daily yesterday that says that the headline is CBO tax cuts prevent a deficit reduction. Are you familiar with that, Dr. Orszag?

Mr. ORSZAG. I am certainly familiar with the letter upon which that story was based.

Mr. MOORE. In fact, you wrote the letter, I believe; is that correct?

Mr. ORSZAG. I did indeed, yeah.

Mr. MOORE. All right. And just the first paragraph says a new analysis by the nonpartisan CBO, Congressional Budget Office, found that projected budget deficits would have been largely wiped out and possibly turned into surpluses had it not been for President Bush's 2001 and 2003 tax cuts. Is that a fair report of what your letter said?

Mr. ORSZAG. Again, what we found is that the tax cuts reduced revenue by about $200 billion this year and that is slightly higher than our projected deficit for the year.

Mr. MOORE. All right. Are all tax cuts created equally?

Mr. ORSZAG. No.

Mr. MOORE. In terms of economic stimulus?

Mr. ORSZAG. No.

Mr. MOORE. All right. And I was at the White House about four or four and a half months ago, I think, as a leader of a group called Lid'l Commission. In fact, I said, Mr. President, we need to find ways to work together, so I appreciate the invitation here.

And when we were leaving, he said, you know what you said there about working together, we can. The President is saying this to me. He says probably not on tax cuts, but in other areas. And I said, Mr. President, even on tax cuts, it does not have to be all or nothing.

For example, you have asked for total repeal of estate tax. I have a bill that would increase the exemption to three and a half million dollars a person. I said that would cover 99 percent of the estates in this country and the small businesses and family farms you talk about. And he said to me, you know, Dennis, maybe we could find some areas to work together on tax cuts.

And what I am saying here is, again, does it have to be all or nothing when it comes to repeal of the estate tax?

Mr. ORSZAG. Certainly that is a policy choice and it need not be all or nothing.

Mr. MOORE. And I am not asking you to make a policy decision, but that is going to cost billions and billions of dollars in lost revenues; is that correct?

Mr. WALKER. That is correct. But it is not just an issue of the numbers and they are important. I think the other thing you have to think about is what would American society look like 50 to 100 years from now if you eliminated the estate tax.

Mr. MOORE. Yes. Thank you very much to both of you and I appreciate your candor here.

Thank you, Mr. Chairman.

Chairman SPRATT. Mr. Baird.

Mr. BAIRD. Thank you very much, gentlemen. Thanks for the fiscal wake-up tour.

Mr. Walker, I understand Mr. Orszag addressed this, but I would like to hear your very succinct comment. Did the tax cuts that we have seen over the last number of years pay for themselves?

Mr. WALKER. Absolutely not. Very few tax cuts pay for themselves.

Mr. BAIRD. We can quote you on that as absolutely not?

Mr. WALKER. Absolutely not.

Mr. BAIRD. So that the——

Mr. ORSZAG. Absolutely they can quote you as saying absolutely not.

Mr. WALKER. Absolutely you can quote me as saying absolutely not.

Mr. BAIRD. So if we have seen a decline in the deficit, the decline in the deficit is not a direct result of the tax cuts?

Mr. WALKER. As Dr. Orszag had said before, some tax cuts, you recapture part of the costs of some tax cuts, but the type that we have seen recently, they do not pay for themselves. And that is primarily due to economic growth which is why we are seeing revenues go up.

I think what it is important for you to understand is if we have any inflation at all, if we have any economic growth at all, revenues are going to go up if you do nothing. The question is, are they higher than otherwise they would have been had the action not been taken.

Mr. BAIRD. And the answer to that question is?

Mr. WALKER. They do not pay for themselves, so, no, they are not higher than they otherwise would have been had the action not been taken.

Mr. BAIRD. Thank you.

Mr. ORSZAG. If I could just add very briefly, it is important to realize that the revenue as a share of GDP resurgence that we have seen is concentrated very disproportionately in the corporate income tax, not in the individual income tax. Most of the policy changes that occurred were in the individual income tax.

Of the 1.9 percentage increase in revenue as a share of GDP between 2003 and 2006, 1.5 percentage points, the vast majority are attributable to the corporate income tax. Corporate profits are significantly up and that is bringing in more revenue.

Mr. BAIRD. I profoundly wish every talk radio host in America could hear what you two gentlemen just said so we get over this nonsense that taxes were cut, revenues have gone up, deficit has gone down, ergo it was because of the tax cuts.

Second question. We heard our friends on the other side talk about mandatory spending. We have got to deal with mandatory spending.

What do you think will be the estimated increase in the long-term deficit or the deficit spending of this country due to the Medicare Prescription Drug Bill that we passed a few years ago? How much did that add to the deficit of the debt?

Mr. WALKER. The estimated discount at present value of cost of that bill for the next 75 years is $8 trillion. In other words, you would have to have $8 trillion today invested at treasury rates to close the gap between what premiums are expected to bring in and what costs are expected to be. And that is worse for more than 75, but——

Mr. BAIRD. I have heard it said by folks who supported that bill, gee, there was a lot of consternation when we passed it, but now 75 percent of seniors who participate think it is a pretty good deal. Sure, because they are passing $8 trillion of debt on to their kids to pay for the short-term apparent discount in the drugs. Is that a fair portrayal possibly?

Mr. WALKER. When 75 percent of the costs for most people are paid for by future generations, it sounds like a pretty good deal for today's generation, but not a good deal for tomorrow's.

Mr. BAIRD. Would a constructive reform dealing with the Social Security debt over the long haul be to actually start making our deficit figures be, deficit figures including borrowing from Social Security, would that at least help us be honest in our budgeting?

Mr. WALKER. I believe that we ought to modify our financial reporting to be able to show what the operating deficit is and the operating deficit excludes the Social Security surplus because if you take, for example, OMB's latest projection for this year, $205 billion deficit, you got to add another 175 to 180 billion on top of that which is the amount of the Social Security surplus we are spending.

You know, my view is that one thing is for sure. We are going to deliver on those bonds and we took the people's money. We spent the people's money. And I think we need to reconsider the accounting treatment at least as it relates to the current Social Security surplus and accumulated related debt.

Mr. BAIRD. Thank you very much.

You mentioned triggers for mandatory spending. I 100 percent agree with that. We also have revenue triggers. In other words, if the deficit reaches a certain level, then there are automatic revenue triggers.

Mr. WALKER. Well, I think we need to have triggers for tax preferences, okay, which is another form of mandatory, back-door spending, if you will. So when tax preferences ended up costing us more than we think they are going to cost, then that would cause a, you know, fundamental reconsideration of those.

Mr. BAIRD. One final question. You mentioned the issue of foreign debt. I greatly am concerned about that as well. There is a lot of talk in this Congress now about forcing the Chinese to revalue their RNB. It seems to me that may have a significant impact on their willingness to carry some of our debt.

Any thoughts on that very briefly?

Mr. ORSZAG. I guess I have two thoughts. I know this topic came up on the foreign debt hearing that this Committee held a couple months ago. We are running a risk. It is unclear how big a risk it is, but we are running a risk by relying on foreign financing of the current account deficit and that requires continued willingness of foreign investors to invest in U.S. dollar assets.

I do not think anyone can tell you, the smartest guy on Wall Street or the smartest financier on Wall Street cannot tell you what exactly could trigger a collapse in confidence that would undermine the willingness of foreign investors to invest in the United States. There are such financiers who are worried about that risk. But we are running some risk and what exactly would trigger a potential collapse is unclear. But if that were to occur, the consequences could be quite severe.

Mr. WALKER. Let me remind you what happened in 1954 when NASIR took over the Suez Canal and the UK and France and Israel did not like it and wanted to take steps to challenge that. And the U.S. was the biggest holder of UK debt and was supporting the pound. A call was made from very high up in the

United States to the UK to ask them to reconsider their action. That was an ally.

It is fundamentally imprudent to rely upon foreign investors to the extent that we are today because they hold more of our nation's mortgage. They will have more influence on us. We will have less influence of them. Debt payments go overseas to benefit them, not to benefit us. And we are increasingly at risk.

Now, there are some synergies, there is some commonality of interest between us and the Chinese and others. And, frankly, we are lucky they are willing to lend us their money because we have a savings deficit. So we should be thankful for that. But we need to recognize the structural problem and start to deal with it.

Mr. ORSZAG. If I could just add to that. People have noted that there is an incentive for foreign investors to continue investing in the United States, but it is unprecedented for the world's leading economic power to be saving only one or two percent of its national income.

And many observers have, therefore, noted that effectively we are in a dysfunctional relationship with the rest of the world. And the thing about dysfunctional relationships is they can go on longer than you expect, but then end faster than you think. And the same risk obtains in our large current account deficit.

Mr. BAIRD. It is interesting how a psychologist can agree with an economist in that observation.

Mr. ORSZAG. There you go.

Mr. BAIRD. I thank you, sir.

Mr. WALKER. Mr. Chairman, if we have one more member, I will try to take a question from that member, but I have got to go.

Chairman SPRATT. We understand.

Ms. Kaptur.

Ms. KAPTUR. Thank you, Mr. Chairman.

Gentlemen, welcome. I guess I am the member.

Mr. WALKER. You are a very important member.

Ms. KAPTUR. I wanted to thank you. I wanted to ask about the value of the dollar versus the euro. I have noticed a gravitation of investment to the euro away from the dollar. Have you noted the same trend?

Mr. ORSZAG. There has been some increased share of official reserves, for example, held by foreign governments in nondollar assets including in the euro. And that is one of the trends, one of the issues for the longer term is we have frankly benefited from the fact that foreign central banks and others have used the dollar as their sort of medium of exchange and invested their assets in dollar-based assets.

If that were to shift, and it is not always guaranteed that the dollar will be the dominant international asset, if that were to shift, that is one of the things that could cause a set of events that would be difficult to control.

Ms. KAPTUR. I was very surprised that the market was jittery this week with the statement of only one mortgage company about the assets, the mortgages that it held. I thought the drop yesterday was, I think, a reflection of the risk you are talking about, that statements by one CEO from one company apparently caused that blip yesterday.

Would you agree that it was rather unusual that one company's statement could cause such a reaction in the market?

Mr. ORSZAG. I think there clearly are elevated concerns about the housing market and the subprime market in particular. And in that context, like in other contexts like our current account deficit where there is an underlying concern, a specific comment or set of comments can generate a disproportionate response.

Mr. WALKER. If I could mention real quickly, I think I am very concerned about the decline of the dollar to the extent that it has declined and whether or not that might be a leading indicator of increasing concern with regard to our long-term outlook. You know, there are competing potential currencies now that could be used as reserve currencies.

One of the things that we need to keep in mind and one of the reasons that oil prices are as high as they are right now is because oil transactions in crude are denominated in dollars. And if the dollar is not worth as much, you have to charge more dollars in order to have the same purchasing power.

And so, I mean, we are increasing our risk and there are other alternatives available.

Ms. KAPTUR. I have been following the price of gold also. That has been going up progressively, has it not, while the dollar has been going down? Am I reading the numbers correctly?

Mr. WALKER. That is not unusual. Yes, it has been going up. But that is not unusual, you know, for that relationship to exist.

Ms. KAPTUR. I wanted to ask. We are focused on the U.S. government's budget and we have heard what you have said about healthcare and the necessity of increasing savings and so forth. But we are looking at the government's share of spending in this economy which has hovered around what, 19, 20, 21, 22 percent, somewhere in there?

Mr. WALKER. A little over 20 percent.

Ms. KAPTUR. For quite a long time. I mean, it varies and it is such a massive budget that it, you know, can vary by hundreds of billions of dollars.

But I see one of the real problems is that if you think about a ship and it is going into rough waters, there are those people who are battening down the hatches and securing the chairs on deck. I sometimes feel Congress is doing that and nobody is paying attention to who is down in the engine room and at the controls of the direction in which the ship is headed. And I think that is where we fail as a country.

And if one looks at the total economy, it is not performing at the level of GDP that it needs to in order to provide the bounce that would normally be there for spending, be it private or public. And I have been noting with greater trepidation the amount of trade deficit this country is racking up which is knocking off quite a significant amount off of our GDP annually, more and more and more.

Do you gentlemen have any knowledge of that or wish to comment on that as the trade deficit is a drag on the growth of overall GDP which inhibits our ability to spend inside this economy?

Mr. ORSZAG. Two quick comments. One is the current account and trade deficits are a reflection of our very low saving rate which does impose a long-term economic burden or sort of constraint on economic growth.

The second thing is I do think that there is, you were touching upon it in some of your comments, a disconnect between macroeconomic performance and the experience that many American families are having in part because there has been a marked increase in income concentration, so a significant amount of macroeconomic performance has accrued to a small percentage of the population.

And, secondly, a phenomenon that has received too little attention is that there is a significant amount of income and earnings volatility that typical families face. For example, CBO has found that one-seventh of American workers experience a 50 percent decline or more each year in their annual earnings. So families seeing that kind of volatility and sluggish real income growth in significant parts of the income distribution may not be paying as much attention to what is happening to overall GDP growth.

Ms. KAPTUR. Dr. Orszag, could I just ask, is that one-seventh——

Chairman SPRATT. No. We have got to go because we are going to have votes in about ten or fifteen minutes. And I will let you lead off with the next panel if that is okay.

Ms. KAPTUR. Is that one-seventh atypical? Is it getting more?

Mr. ORSZAG. On that question, just very briefly, that looks like it has been roughly flat since 1980. There may be other measures that are somewhat high, but basically I think it is high and it has been high for a while.

Mr. WALKER. Two things, Mr. Chairman. Number one, we have four deficits, a budget deficit, a balance of payments of deficits, a savings deficit, and a leadership deficit.

Last thing, this document which I will leave several copies is a document we issued in September of 2005 that talks about the growth of tax expenditures, the importance of getting them on the radar screen, and the importance of subjecting them to some type of budget control and discipline as well.

Thank you, Mr. Chairman.

Chairman SPRATT. Thank you both for your testimony, for your forbearance, and for always the excellent advice you give us. Dr. Orszag, thank you. General Walker, thank you both for coming.

Now, let us have our next panel up as quickly as we can. We are sorry, but it is in the nature trying to plan anything in this institution. We do have some votes coming up on the floor. Could be in ten minutes. I am not sure. I hope it will be a bit longer.

Bob Greenstein, we will give you the honor of going first.

We welcome to the next panel Robert Greenstein who is the Executive Director of the Center on Budget and Policy Priorities; Robert Bixby who is the Executive Director of the Concord Coalition; Maya MacGuineas who is the President of the Committee for a Responsible Budget; and our old colleague, Pat Toomey. Thank you for coming, all of you, and we will start with Mr. Greenstein.

STATEMENTS OF ROBERT GREENSTEIN, EXECUTIVE DIRECTOR, CENTER ON BUDGET AND POLICY PRIORITIES; PAT TOOMEY, PRESIDENT AND CEO, CLUB FOR GROWTH; ROBERT L. BIXBY, EXECUTIVE DIRECTOR, CONCORD COALITION; MAYA MACGUINEAS, PRESIDENT, COMMITTEE FOR A RESPONSIBLE FEDERAL BUDGET;

STATEMENT OF ROBERT GREENSTEIN

Mr. GREENSTEIN. Thank you, Mr. Chairman.

Chairman SPRATT. Let me say we will make your statements part of the record. You can summarize and to the extent you can talk about the rule itself and making it statutory as opposed to having it part of the House rules and any kind of technical implications, I think that would be useful to us.

Mr. GREENSTEIN. Thank you.

Let me cover several points. Try and do it very quickly. First, adherence to the PAYGO principle is important because, as you know, we face a very serious long-term problem that we cannot afford to make worse.

The Center on Budget has developed long-term budget projections, drawing heavily on CBO projections. Like others, they show current policies are not sustainable.

We find that expenditures for all items other than Medicare, Medicaid, Social Security, and interest payments on the debt are actually expected to shrink as a share of GDP in coming decades, but that projected increases in cost for Medicare, Medicaid, and Social Security will swamp the improvements in the rest of the budget and produce deficits if we remain on the current policy course of about 12 percent of GDP by 2050 and debt in the vicinity of about 115 percent of GDP.

Now, I should note that those projections I just mentioned assume compliance with PAYGO on both sides of the ledger.

If, for example, one assumes that the tax cuts enacted in 2001 and 2003 are made permanent without offsets, but that any entitlement increases are paid for, then the deficit by 2050 is expected to equal about 20 percent of GDP and the debt about 230 percent of GDP, about double what it would be if the tax cuts—are any tax cuts that are expended are paid for.

[Slide]

Mr. GREENSTEIN. The key reason for this is simply, and the first slide, if it can be put up, show this, the key reason for this is simply that the increase in deficits that the extending the tax cuts without paying for them would cause would trigger increased interest costs that would compound over time and make the debt spiral much worse.

In other words, under current policies even with strict adherence to PAYGO, deficits and debt are projected to rise to dangerous levels. Without PAYGO or with PAYGO limited to the spending side, deficits and debt are likely to explode.

Looked at another way, eventually Congress is going to have to fill the budget hole because it cannot allow a debt explosion to occur and adherence to PAYGO is necessary to keep the eventual deficit reduction packages from being so huge that they consist of draconian budget cuts or confiscatory tax increases.

Point number two, PAYGO was highly effective in the 1990s. The record shows that Congress paid for virtually all of the entitlement increases and tax cuts up to 1999 including extending of expiring measures on both the tax cut and spending side of the ledger.

I would note that PAYGO was established and maintained in the 1990s on a bipartisan basis that started with an agreement between a Republican President and a Democratic Congress. It was ratified and extended in 1997 by a Democratic President and a Republican Congress.

A third point is PAYGO is not intended to prevent program expansions or tax cuts. It simply says if a tax cut or a program expansion is worth having, it is worth paying for. There are numerous examples.

In 1997, you paid for the establishment of the SCHIP Program and a major package of tax cuts by a series of savings measures, particularly in Medicare provider payments.

Similarly in the Higher Education Bill recently passed on the House floor, the Pay as you Go rule did not prevent you from cutting the interest rate students pay on loans. It required simply that it be paid for.

And to those members who are concerned about unmet needs in the country, I would only say that if we do not have a PAYGO rule, I think eventually we will end up with cuts so deep that unmet needs will increase, not shrink.

My fourth point I do not have time to cover in the oral testimony. It is explained in full in the testimony. And I am happy to answer questions on it. It is simply that it is not the case that the PAYGO rules would be biased in favor of entitlements and against tax cuts. There is much misunderstanding on that. Happy to answer questions on that. Testimony explains it in full. I cannot do it in three sentences.

My last point is about tax cuts and the economy, it is sometimes said that we cannot, should not require tax cuts to be paid for because that would damage the economy. Now, there is agreement, Mr. Chairman, among mainstream economists that well-designed tax cuts can have some positive, although relatively modest, long-term effects on the economy, but there is also agreement among mainstream economic analysts that any potential positive effects of lower tax rates are swamped by the negative effects of persistent large deficits.

Several years ago, CBO found that a ten percent across the board income tax rate cut if deficit financed could reduce economic output. The Joint Tax Committee and the Congressional Research Service have both issued an analysis finding the tax rate cuts that are deficit financed are likely to reduce economic growth over the long run.

And last year, the Administration issued a study designed to tout the importance of making its tax cuts permanent. That study found relatively small but some positive long-term economic gain from doing so, but that study found the economic gain, the Administration's own study, only if the cost of making its tax cuts permanent was offset.

In other words, the conclusion is clear that whatever long-term economic benefits tax cuts may offer, they are only realized in the long term if the cost of the tax cuts is offset, that is if it is consistent with PAYGO discipline.

The potential for some economic benefit from well-designed tax cuts if they are paid for offers support for the principle that tax cuts along with entitlement expansions should be subject to PAYGO rather than for the argument that tax cuts should be exempt.

Lastly, let me briefly comment on your question of does it add to have this in statute in addition to having it in the rule. I believe it does and in one particular way. If PAYGO is only a rule, then it is not that difficult for a new Congress to wipe away the rule. If it is in statute, you would need to pass another statute to repeal it. And that would require most likely 60 votes in the Senate and a signature by the President.

So establishing PAYGO in statute makes PAYGO much more stable and long lasting than only having it in a rule that may only apply in a particular Congress.

Thank you.

[The prepared statement of Robert Greenstein follows:]

PREPARED STATEMENT OF ROBERT GREENSTEIN, EXECUTIVE DIRECTOR, CENTER ON BUDGET AND POLICY PRIORITIES

Chairman Spratt, Congressman Ryan, and members of the Committee, I appreciate the opportunity to appear hear today to explain why I think the pay-as-you-go discipline is important and appropriate, and why establishing a statutory pay-as-you-go rule to reinforce Congressional rules is a sound idea.

My testimony will cover the following:

- Adherence to the pay-as-you-go principle is important because we face an extremely serious long-term budget problem and cannot afford to make that problem worse through entitlement increases or tax cuts that are deficit financed, rather than offset;
- The pay-as-you-go rule proved in the 1990s to be a highly effective tool to help restore fiscal responsibility;
- Pay-as-you-go does not prevent Congress and the President from enacting program expansions or tax cuts; it simply requires that the costs of those actions be paid for;
- Pay-as-you-go is not biased in favor of entitlement expansions and against tax cuts;
- There is not a valid argument for exempting tax cuts from pay-as-you-go on the grounds that requiring the cost of tax cuts to be paid for will hurt the economy;
- Establishing a statutory pay-as-you-go procedure backed up by sequestration will not produce a dramatic improvement compared with the current Congressional pay-as-you-go rules, but it will help to highlight and reinforce the importance of pay-as-you-go and, in particular, make it harder for a future Congress to quietly back away from pay-as-you-go.

Let me address each of these points in more detail.

Pay-as-you-go is Vital Because of the Long-term Fiscal Problem Facing the Nation

As the members of this Committee know all too well, there are many disagreements about the budget—disagreements about the appropriate level of taxes and spending, about priorities among federal programs, and about the kinds of tax and entitlement reform that would be appropriate. But virtually all budget analysts agree on one thing: the federal budget is unsustainable under a continuation of current policies. The looming retirement of large numbers of baby boomers and—more importantly—the continuing rapid growth in the cost of providing health care throughout the U.S. health care system will cause federal expenditures to rise more rapidly than revenues in coming decades. If changes in policies are not made to slow the growth of expenditures (which will primarily entail slowing the growth in health care costs), to increase revenues, or to do a combination of the two, federal deficits and debt will soar in coming decades to levels that will cause serious damage to the economy.

The Congressional Budget Office has reached this conclusion.[1] So has the Government Accountability Office.[2] So has the Bush Administration.[3]

The Center on Budget and Policy Priorities has developed its own set of long-term budget projections (drawing heavily on projections produced by CBO), which, like other projections, show that current policies are not sustainable.[4]

We find that expenditures for all items other than Medicare, Social Security, and Medicaid (excluding interest payments on the debt) are actually expected to shrink by 3.9 percent of GDP between now and 2050. But projected increases in costs for Medicare, Medicaid, and Social Security—driven by increases in health care costs system-wide and the aging of the population—will swamp the contraction in the rest of the budget, result in huge increases in interest payments, and produce deficits of approximately 12 percent of GDP by 2050 and debt in the vicinity of 115 percent of GDP, which would be the highest level of debt in the nation's history. (Note: the key factor is the expected growth in health care costs per person throughout the U.S. health care system, in the private and public sectors alike, which drives up costs for Medicare and Medicaid. For the past 30 years, per-beneficiary costs have grown at virtually the same rate in Medicare and Medicaid as in private-sector health care, a development this is expected to continue.)

These projections assume that Congress and the President comply with the pay-as-you-go rule, and that discretionary spending grows at the rate of inflation and population, thereby declining somewhat relative to the size of the economy. That means these projections rest on an assumption that any increases in entitlement program expenditures, such as for expansion of the SCHIP program, will be paid for by reductions in other entitlements or increases in revenues. It also means that these projections assume that tax cuts relative to current law (including extensions of tax cuts enacted in 2001 and 2003), will be paid for by increases in other taxes or reductions in entitlement spending.[5]

If, however, one assumes instead that the tax cuts enacted in 2001 and 2003 are made permanent without offsets (while maintaining all of the other assumptions, including that no entitlement expansions are enacted without being paid for), the deficit in 2050 is projected to equal about 20 percent of GDP, and the debt would total approximately 230 percent of GDP, or twice what the size the debt will be if those tax cuts that are extended are paid for. A key reason the deficit and debt levels would be so much higher if the tax cuts were made permanent without their costs being offset is that the increase in deficits that the tax cuts cause would trigger increased interest costs that would compound over time and make the debt spiral markedly worse. This is the case even though our projections do not assume that interest rates would rise; if they do (as is likely), the situation would be even worse.

In other words, under current policies, even with strict adherence to the pay-as-you-go rule, deficits and debt are projected to rise to dangerous levels. Without pay-as-you-go policies, deficits and debt are likely to explode.

It is a cliche to say that when you find yourself in a hole, the first thing you should do is to stop digging, but it is a cliche that offers sound advice. We are in a hole. We eventually are going to have to start filling that hole in (by slowing the overall growth of programs—primarily by slowing the growth in the system-wide cost of providing health care—and by increasing revenues). But in the meantime, we should not dig the hole even deeper.

Looked at another way, eventually Congress simply will have to fill the budget hole, since it cannot allow a debt explosion to occur. Hence, the figures presented here show the projected amount of deficit reduction that Congress will need to enact in the future. Adherence to the pay-as-you-go rule is necessary to keep the eventual deficit reduction packages from being packages of enormous magnitude that consist of draconian cuts in basic programs and services or confiscatory tax increases. Every violation of pay-as-you-go will require an offsetting program cut or tax increase to be enacted later. A key reason to adhere to pay-as-you-go is to limit to some extent the amount of extraordinarily heavy lifting that future Congresses will have to do.

The laws of budgeting and economics mean that program increases or tax cuts eventually must be paid for. The pay-as-you-go rule essentially says that since this is so, it is only fair that a Congress that desires a program increase or a tax cut also should find the offset.

PAY-AS-YOU-GO WAS A HIGHLY EFFECTIVE TOOL IN THE 1990S

The pay-as-you-go approach proved very effective in the 1990s, when a statutory rule was in effect, along with a Senate procedural rule. Congress paid for all of its entitlement increases and tax cuts, including the extension of expiring measures such as the "tax extenders." Along with a vibrant economy (which was likely helped by the federal government's commitment to fiscal discipline), pay-as-you-go helped lead to the first federal budget surpluses in nearly 30 years. Pay-as-you-go discipline was adhered to without deviation until surpluses reemerged.

In a very real sense, we are in a deeper hole now than we were in 1990, when the original pay-as-you-go rule was enacted. Although the deficit is smaller now than it was then, we are much closer to the point where rising health care costs and demographics will cause deficits and debt to escalate sharply. Reestablishing and abiding by the pay-as-you-go rule is a very important first step in beginning to deal with that long-term problem.

It is important to note that the pay-as-you-go rule was established and maintained in the 1990s with bipartisan support. The original rule grew out of an agreement between a Republican President (the first President Bush) and a Democratic Congress. The rule was ratified and extended in 1997 by a Democratic President (Bill Clinton) and a Republican Congress. Concern over growing deficits motivated a significant number of members from both parties to support adoption or extension of the pay-as-you-go rule. As noted, the pay-as-you-go statute was adhered to without exception until 1999, when budget surpluses reappeared and seemed to be growing rapidly.[6]

Support for the rule did not reflect agreement on budget priorities—and did not need to. In both 1990 and 1997, many Republicans feared that Democrats would try to enact significant increases in entitlement programs, while many Democrats feared that Republicans would try to enact large tax cuts. The pay-as-you-go rule allowed each side to make sure that the other side could not move ahead with its priorities without paying for them.

PAY-AS-YOU-GO DOES NOT PREVENT PROGRAM EXPANSIONS OR TAX CUTS

Pay-as-you-go is not intended to—and does not—prevent entitlement expansions or tax cuts. Rather, it is intended to force proponents of entitlement expansions and tax cuts to find ways to offset the cost of their proposals. In the 1990s, it certainly prevented enactment of various spending increases and tax cuts that members of Congress concluded were not worth paying for, but it did not keep other, higher-priority entitlement expansions or tax cuts from being enacted. This was vividly illustrated in 1997, when entitlement cuts in the Balanced Budget Act of 1997 offset the cost of establishing the SCHIP program in that Act as well as the cost of tax cuts included in the Taxpayer Relief Act of 1997.

We also see in this new Congress that pay-as-you-go does not prevent action on priorities; it simply means that proponents have to find ways to pay for those priorities. We saw this at work in the higher education bill that the House recently passed. The pay-as-you-go rule did not prevent that bill from cutting the interest rate that students have to pay on subsidized loans, but did require that proponents of that policy change find ways to offset the cost. Similarly, the pay-as-you-go rule will not prevent Congress from extending alternative minimum tax relief this year, but will force the tax-writing committees to search for ways to offset the cost of that relief. Pay-as-you-go certainly makes it harder to take action to meet various priorities, but the payoff of not adding to the long-term deficit problem is worth making proponents of such actions work harder. If the proposed program expansion or tax cut is really worth enacting, it is worth paying for.

It is also important for proponents of program expansions to realize that adding to deficits now by enacting unpaid-for program expansions or tax cuts will increase the magnitude of the program cuts and tax increases that will be needed in coming years to bring exploding deficits under control. Thus, failing to abide by pay-as-you-go now will make it harder to sustain key programs and meet vital needs in the future.

PAY-AS-YOU-GO IS NOT BIASED IN FAVOR OF SPENDING AND AGAINST TAX CUTS

Despite the fact that the pay-as-you-go rule applies equally to entitlement expansions and tax cuts, the Administration and some others have argued that entitlement expansions are favored under the pay-as-you-go rules because entitlements and revenues are treated differently in the budget baseline used in determining the cost of legislation. For instance, Office of Management and Budget Director Rob Portman concluded last year that there is a bias in the baseline rules for spending and against tax relief "Because we assume that programs go out indefinitely on the spending side. * * * Whereas on the tax side, we assume the tax relief would not continue."

Careful examination shows, however, that this argument is not valid. The general baseline rules treat temporary provisions of the tax code exactly the same as temporary provisions of entitlement programs. Moreover, a special rule dealing with the few cases where an entire entitlement program expires (such as SCHIP) does not give an advantage to those programs either.[7]

The general baseline rule for projecting the cost of entitlement programs (direct spending) and revenues (receipts) is set forth in section 257(a) of the Balanced Budget and Emergency Deficit Control Act of 1985, as amended.[8] The Act states that the projections of entitlement spending and revenues are to be based on the assumption that "Laws providing or creating direct spending and receipts are assumed to operate in the manner specified in those laws for each such year. * * *"

When CBO or OMB analysts prepare a baseline projection of revenues for the next five or 10 years, they base their projection of revenues in each year on the provisions of the tax code that would be in effect in that year. That means they would take into account the fact that the 2001 tax legislation reduced most income tax rates through 2010, but provided for those rates to return to prior levels after 2010. Thus, legislation that changed current law to extend the lower rates beyond 2010 would be charged with the costs of lowering the rates in those years.

In general, the CBO analysts do the same thing when they project expenditures for entitlement programs; they take into account the provisions governing each program that would be in effect in each year under current law. For instance, since Congress has extended Medicaid's Transitional Medical Assistance (TMA) provisions only through September 30, 2007, the baseline projections of Medicaid expenditures assume that the TMA provisions will expire on that date. Legislation to extend the TMA provisions beyond that date would be charged with the cost of the estimated increase in spending that results from extending those provisions. Neither the baseline nor the CBO scoring rules provide an advantage to the legislation to extend an expiring entitlement provision over legislation extend an expiring tax provision.

There is a special baseline rule that applies in the relatively few instances where Congress has decided that an entire mandatory program should be reexamined periodically and, to make sure the reexamination occurs, has provided that the entire program (as opposed to certain provisions of the program) will expire if legislation to extend the program is not enacted. For instance, the SCHIP program is scheduled to expire at the end of this year, which has led the current Congress to reevaluate the program. In cases where entire programs expire under current law, the baseline rules provide that projections of spending for those programs should assume that the laws governing those programs will be extended as in effect at the time of expiration.[9]

There is no similar rule in the case of taxes because the tax code does not comprise a collection of separate programs, and neither the entire tax code nor the entire personal income tax is slated to expire.[10] A temporary change in a provision within the tax code, such as a temporary provision lowering a particular tax rate, is analogous to the temporary extension of Medicaid's TMA provision, which is assumed to expire in the baseline just as the temporary reductions in certain tax rates are. Under current law, income tax rates will change in 2011, but the income tax itself will not expire.

Most importantly, the expiring entitlement programs that are assumed to continue in the baseline receive no overall advantage relative to expiring tax-cut provisions. When estimating the costs of legislation that would establish or extend an entire entitlement program that is assumed to continue in the baseline, CBO scores the cost of that legislation for every year of the 10-year "budget window." Congress can not make the cost of that legislation appear smaller by scheduling the new program to expire after a few years; CBO will score the costs in every year regardless. In contrast, legislation that schedules a tax-cut provision to expire is scored only for the cost of the tax cut in the years it is in effect. If both the program and the tax-cut provision are extended, the end result is the same. The full costs of both the program and the tax cut over the whole period are scored, although the full costs of the program are scored up front when it is established, while part of the cost of the tax cut is scored when it is first enacted and the rest is scored when the tax cut is extended.

To understand how this works, consider the following simple example. A new entitlement program and a tax provision are enacted at the same time. Each is scheduled to expire after two years, each is estimated to cost $5 billion over five years if extended ($2 billion in the first two years and $3 billion over the last three years), and each is then extended for three more years in later legislation.

- If the entitlement program is assumed to continue in the baseline, the original legislation establishing the program will be scored as costing $5 billion over five years, even though the program is slated to expire after two years. The subsequent legislation extending the program will be scored as having no cost.
- The original legislation containing the tax-cut provision will be scored as costing only $2 billion, while the subsequent legislation extending the provision will then be scored as costing $3 billion over the following three years.

• Thus, the new entitlement program and the tax-cut provision will each be scored as costing $5 billion over five years. The new entitlement program gained no advantage from the baseline assumption that it would be continued.

If proponents of the tax cuts believe that being charged with the cost of the tax cut in two installments is disadvantageous—even though the total cost is no greater than if the tax cuts had been treated as permanent in the baseline and the original legislation had been scored on that basis—they can avoid that outcome by making the tax-cut provisions permanent to start with. In recent years, tax-cut proponents often have purposely opted for the installment approach, because they concluded that doing so would be to their strategic advantage. Sunsetting a tax cut after a few years can make the cost appear lower when the tax cut is first considered, making it possible to pass larger tax cuts than would otherwise be possible.[11] Once the larger tax cut has been passed, its proponents then argue that it must be extended to avoid subjecting the public to a "tax increase."

REQUIRING THE COST OF TAX CUTS TO BE OFFSET WILL NOT DAMAGE THE ECONOMY

The argument that not extending expiring tax cuts will damage the economy, or that enacting other new tax cuts will boost the economy, is used by some to argue that the pay-as-you-go rule should not apply to tax cuts. In its most extreme form, the argument is that applying the pay-as-you-go rule to tax cuts does not make sense because tax cuts pay for themselves—that is, that tax cuts boost the economy so much that revenues are higher than they would have been without the tax cuts.

In reality, tax cuts do not have such magical effects. There is agreement among mainstream economists that tax cuts generally have relatively modest long-term effects on the economy—other factors are much more important in determining the performance of the economy—and that, even under the best of circumstances, they do not boost the economy enough to come remotely close to paying for themselves.

Perhaps most importantly, mainstream economic analysis shows that the potential negative effects on the economy of higher tax rates (or the potential positive effects of lower tax rates) are smaller than the negative effects of allowing persistent, large deficits. This point was underscored in a recent response by the Congressional Budget Office to questions posed by Senate Budget Committee ranking Member Judd Gregg (R-NH) about the effects of raising taxes or cutting spending to achieve a sustainable long-term fiscal path. CBO explained:

"Differences in the economic effects of alternative policies to achieve a sustainable budget in the long run are generally modest in comparison to the costs of allowing deficits to grow to unsustainable levels. In particular, the difference between acting to address projected deficits (by either reducing spending or raising revenues) and failing to do so is generally much larger than the implications of taking one approach to reducing the deficit compared with another."[12]

This is consistent with CBO's earlier finding that, if deficit financed, a 10-percent across-the-board cut in income tax rates could potentially reduce economic output.[13] It is also consistent with the a letter CBO sent to Chairman Spratt last week on the cost of the 2001 and 2003 tax cuts, which concluded that "at this point in time (several years after enactment), * * * the overall impact of the tax legislation [on the economy] is likely to be modest. * * *" and that, when that impact is taken into account, the actual cost of the tax cuts is likely to be about the same as the official cost estimates made at the time of the tax cuts' enactment (which did not take economic feedback effects into account).[14] Similarly, in an analysis of the effects of reductions in individual and corporate tax rates that are deficit financed, the Joint Committee on Taxation found that: "Growth effects eventually become negative without offsetting fiscal policy [i.e. without offsets] for each of the proposals, because accumulating Federal government debt crowds out private investment."[15] And, in an analysis of the argument that the tax cuts enacted in 2001 and 2003 cost less than was estimated at the time of enactment because they boost economic growth, the Congressional Research Service concluded in a September 2006 report that, "at the current time, as the stimulus effects have faded and the effects of added debt service has grown, the 2001-2004 tax cuts are probably costing more than expected."[16]

Even the Bush administration has concluded that the long-term economic effect of the tax cuts will be quite small if they are made permanent. A Treasury Department study found that making the 2001 and 2003 tax cuts permanent would increase the size of the economy over the long run (i.e., after many years) by only 0.7 percent—and that even this small growth increment would occur only if the tax cuts were paid for in full by unspecified cuts in government programs.[17]

As an indication of how modest a long-term increase in the economy of 0.7 percent would be, if it took 20 years for the increase to fully manifest itself (Treasury officials indicated it would take significantly more than 10 years but were not more specific than that), this would mean an increase in the average annual growth rate for 20 years of four-one hundredths of one percent—such as 3.04 percent instead of 3.0 percent. Such an effect is so small as to be barely perceptible. Moreover, after the 20 years (or whatever length of time it would take for the 0.7 percent increase to show up), annual growth rates would return to their normal level—that is, they would be no higher than if the tax cuts had been allowed to expire.

Congressional and executive branch economic experts are not the only ones to reach the conclusion that deficit-financed tax cuts are unlikely to substantially boost long run economic growth. University of California economist Alan Auerbach, a noted expert in fiscal policy, simulated the economic effects of the 2001 reductions in marginal tax rates, increase in the child tax credit, "marriage penalty relief," and AMT relief under various financing assumptions. He found that the only scenario under which the tax cuts increased the size of the capital stock and thus increased long-run economic output was one in which they were fully paid for with spending cuts at the time they were enacted. Auerbach concluded that "whatever its benefits, the tax cut [enacted in 2001] does not offer the promise of enhancing savings and expanding output in the long run." [18]

The clear conclusion is that whatever long-term economic benefits tax cuts might offer, those benefits will only be realized if the cost of the tax cuts is offset—that is, if enactment of the tax cuts is consistent with pay-as-you-go discipline. The potential for economic benefits from tax cuts if they are paid for offers support for the principle that tax cuts should be subject to pay-as-you-go, rather than for the argument that tax cuts should be exempt from such fiscal discipline.

ENACTING A STATUTORY PAY-AS-YOU-GO RULE WOULD HELP PROMOTE ADHERENCE TO PAY-AS-YOU-GO

Finally, I would like to briefly discuss why enacting a statutory pay-as-you-go rule would be helpful. The House and the Senate have already taken the most important step toward establishing pay-as-you-go discipline by imposing rules that prohibit consideration of legislation that would increase entitlement spending or cut taxes if the costs of those actions are not offset. Establishing a statutory pay-as-you-go rule backed up by sequestration would not dramatically enhance the effectiveness of those rules. (Congress could include a waiver of the statutory pay-as-you-go requirement in future legislation, just as it can waive its own rules to consider legislation that violates pay-as-you-go.)

Nevertheless, enacting a statutory pay-as-you-go rule could add force to the Congressional rules by emphasizing the importance of adherence to pay-as-you-go and, in particular, by making it harder for future Congresses to quietly back away from adherence to pay-as-you-go. Once pay-as-you-go was written into law, it could be removed from the law (before its scheduled expiration date if there were one) or set aside on a case-by-case basis only by enactment of a statute that would require the assent of the President and, most likely, support from a supermajority in the Senate to become law. A statutory pay-as-you-go requirement also could have the virtue of improving the budgeting culture in Executive Branch agencies by reinforcing the idea that, when entitlement expansions or tax cuts are discussed, a key question should be "how will the costs be paid for?"

CONCLUSION

Enactment of a statutory pay-as-you-go rule would be highly desirable. But whether a statutory rule is established or not, what is of most importance is that Congress maintain a commitment to adhere to pay-as-you-go discipline even when living by that rule is not easy. Given the bleak long-term fiscal outlook for the nation, we cannot afford for Congress to do otherwise.

ENDNOTES

[1] "The Long-Term Budget Outlook," Congressional Budget Office, December 2005.

[2] "The Nation's Long-Term Fiscal Outlook: April 2007 Update," Government Accountability Office, April 2007.

[3] "Mid-Session Review of the Budget of the United States: Fiscal Year 2008," Office of Management and Budget, July 11, 2007, p. 6.

[4] Richard Kogan, Matt Fiedler, Aviva Aron-Dine, and James Horney, "The Long-Term Fiscal Outlook is Bleak: Restoring Fiscal Sustainability Will Require Major Changes to Programs, Revenues, and the Nation's Health Care System," Center on Budget and Policy Priorities, January 29, 2007.

[5] The projections do assume that current relief from the Alternative Minimum Tax will be extended without offsets, because the AMT would practically replace the regular income tax by 2050 if the relief were not extended.

[6] During the 1990s, every entitlement increase and tax cut was paid for. The only exception occurred in 1993, at a time when unemployment remained high, when the final six-month continuation of "extended unemployment benefits" was declared an emergency by both Congress and the President and for that reason was not subject to the PAYGO statute.

[7] For a more detailed discussion of this issue, see James Horney and Richard Kogan, "Key Argument Against Applying Pay-As-You-Go to Tax Cuts Does Not Withstand Scrutiny," Center on Budget and Policy Priorities, March 22, 2007.

[8] The current rules were essentially established in the Budget Enforcement Act of 1990, which amended the Balanced Budget Act, and are often called the "BEA" baseline rules.

[9] The special rule only applies to programs that cost more than $50 million a year, and applies to a program established after 1997 only if he House and Senate Budget Committees have determined at the time of enactment that the programs should be assumed to continue.

[10] There is a special rule that says that expiring excise taxes that are dedicated to a trust fund should be assumed to continue. This could be viewed as one case where a set of taxes constitute a program. More importantly, these taxes fund highway and transit programs that expire under current law but are assumed to continue in the baseline.

[11] Sunsetting 2001 tax cuts that were intended to be permanent was one of a number of gimmicks used in a process that former Ways and Means Committee Chairman Bill Thomas described as an effort "to get a pound and a half of sugar in a one-pound bag." From "News Conference with Representative Bill Thomas, Chairman of the House Ways and Means Committee," Federal News Service Transcript, March 15, 2001.

[12] Congressional Budget Office, "Financing Projected Spending in the Long Run," attachment to letter to Senator Judd Gregg, July 9, 2007, p. 1.

[13] Congressional Budget Office, "Analyzing the Economic and Budgetary Effects of a 10 Percent Cut in Income Tax Rates," December 1, 2005.

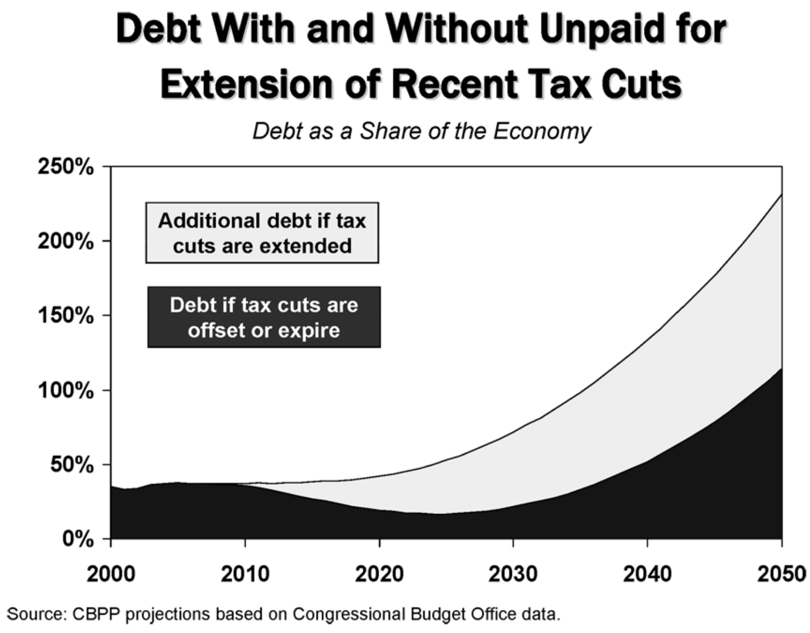
[14] CBO estimated that the cost of the 2001 and 2003 tax cuts, incorporating economic feedback effects, is roughly $195 billion to $215 billion (including debt-service costs), compared with the official estimate (without feedback effects) of $211 billion. Letter of July 20, 2007, from Peter R. Orszag, Director of the Congressional Budget Office, to House Budget Committee Chairman John M. Spratt, Jr.

[15] Joint Committee on Taxation, "Macroeconomic Analysis of Various Proposals to Provide $500 Billion in Tax Relief," JCX-4-05, March 1, 2005.

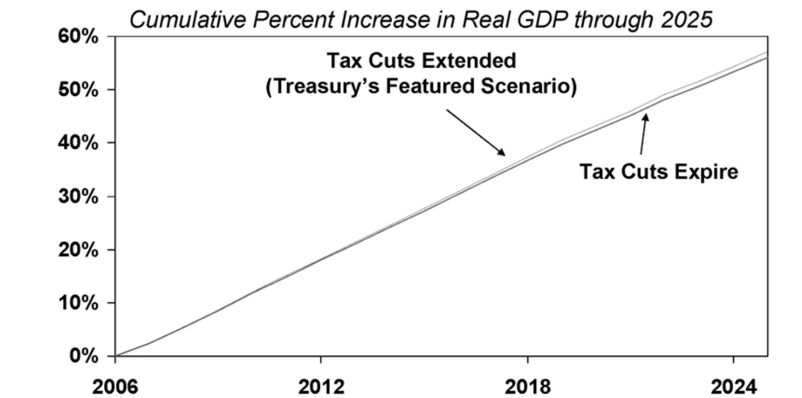
[16] Jane G. Gravelle, "Revenue Feedback from the 2001-2003 Tax Cuts," Congressional Research Service, September 27, 2006.

[17] Department of Treasury, "A Dynamic Analysis of Permanent Extension of the President's Tax Relief," July 25, 2006. For a more detailed discussion of the Treasury study, see Jason Furman, "Treasury Dynamic Analysis Refutes Claims by Supporters of the Tax Cuts," Center on Budget and Policy Priorities, revised August 24, 2006.

[18] Alan J. Auerbach, "The Bush Tax Cuts and National Saving," National Tax Journal, September 2002.



Treasury Department: Long-Run Effects of Tax Cuts on Economy Small, Possibly Negative



Source: CBPP calculations based on Treasury "Dynamic Analysis." Treasury did not provide year-by-year figures, so the path provided is illustrative only. Path assumes full benefits materialize by 2025.

Chairman SPRATT. Thank you, Mr. Greenstein.

Let us go to our old colleague, Mr. Toomey.

STATEMENT OF PAT TOOMEY

Mr. TOOMEY. Thank you very much, Mr. Chairman, Ranking Member Ryan. I certainly do appreciate the invitation to be here and present what I suspect will be the sole contrary view. Being in a very small minority, it is nothing new to me. So I appreciate this opportunity.

Let me say that, and I will try to be brief about this, supporters of PAYGO have long argued that these rules are necessary to reduce the federal deficit. And at the outset, let me acknowledge that reducing the deficit is certainly a well-intentioned objective and not something that we at Club for Growth are in disagreement about.

That said, however, subjecting tax cuts to the PAYGO rule as this proposal does may over time actually take us farther away from this goal rather than bringing us closer to it and in the process, it could do great harm to the American prosperity.

Subjecting tax cuts to the PAYGO rules will not only sound the death now for future tax cuts but will also result very soon, in fact, in the largest tax increase in American history. The resulting tax hike will not go unnoticed by the American economy and a reasonably likely economic downturn that could result could very well lead to a decline in federal tax revenues which would in turn, of course, lead to large deficits.

Now, opponents of the tax cuts have often resisted the inextricable connection between constructive lower taxes, especially marginal tax rates, and economic growth, but even a brief look at the economic benefits that have occurred since the 2003 tax cuts suggests that any rule that precludes their extension and instead forces a reversion to the prior higher rates is quite likely to have an effect of inhibiting economic growth.

A simple comparison of statistics before and after is very informative. In the two years before the 2003 tax relief, American workers lost 2.7 million jobs. During the two years afterwards, the American economy gained 4.3 million jobs. Today we have over eight million new jobs since August of 2003 and the economy continues to create new jobs today.

GDP growth prior, in 2001, for instance, 1.1 percent. Two years after the tax cuts, GDP growth was 3.8 percent. At the time of the 2003 tax cuts, unemployment was 6.1 percent. Two years later, at 5.1. Today at about four and a half.

Prior to the tax relief, business investment had declined for eight straight quarters. After the tax relief, it increased for 15 straight quarters and continues to climb today. And since the 2003 tax cuts, equity markets in general, the Dow Jones Industrial Average in particular, has increased nearly 80 percent.

We think it is very unlikely that this is all a big coincidence. Clearly the 2003 tax cuts played a role in this increased economic growth in this country, but the story does not end there. The increased economic growth over time does, in fact, contribute to increasing revenue and, therefore, a reduction in the federal deficit.

Today, not despite, but in part because of the 2003 tax cuts, federal tax revenue is at an all-time record high. And more importantly, the actual tax revenue being collected today and the last couple years exceeds what CBO projected we would be collecting this year prior to the tax cuts being enacted.

Now, I am not going to sit here and tell you that I can tell you that I know how much revenue we would have brought in had there never been these tax cuts. I would argue that nobody can tell you that. But we can look back at what was projected for this year prior to the tax cuts' enactment. And the fact is we are bringing in more revenue than what was projected at that time.

Of course, increased federal revenue all else being equal leads to lower deficits, not larger deficits, and we are not on track to finish this fiscal year with a deficit on the order of what is really a mere $200 billion or about 1.5 percent of GDP, well below America's post-war average.

So we believe that the relationship between tax cuts, economic growth, revenue, and deficits is a strong relationship and subjecting tax cuts to the PAYGO rule severs this relationship by removing an important catalyst for economic growth.

Ultimately, of course, we view the problem of the proposed statutory version of PAYGO in that it treats tax cuts the same way that it treats new government spending by treating these as equivalents. In fact, that view is predicated on a static view of the world that we think is patently wrong. The economy is not static. It is dynamic in its nature. And as I have mentioned above, new tax cuts properly done can expand economic activity.

But a broader point needs to be made about focusing excessively on budget deficits. While shrinking the federal deficit is important, we think that it is not as crucial as an end in itself as it is a tool to achieve an end and that end is greater prosperity and greater economic growth.

At the end of the day, job growth, higher incomes, gains in family wealth are more important than the number on the government's ledger.

Now, some will argue that deficits detract directly from economic growth by driving up interest rates. What we have seen in recent history suggests that that certainly is not the case in the current environment. We went from significant surpluses to significant deficits and as we went through that process, interest rates tumbled.

That simply proves that interest rates clearly are driven by other factors and not exclusively and probably not even primarily by federal deficits. What really matters is not the absolute size of the deficit but the size of the deficit as a percentage of the economy.

And, finally, let me close by saying that the real budgetary crisis, and this was raised in the previous panel, the real budgetary crisis facing our federal government is not addressed by PAYGO. The real crisis is the unsustained projected growth in entitlement spending both in absolute dollars and as a percentage of GDP. Actual total federal government debt owed to others today is about 37 percent of GDP whereas the unfunded liability of the existing entitlement programs is over 370 percent of GDP.

PAYGO is a very well-intentioned rule, but we think its implementation should not come at the cost of preventing economic stimulating tax cuts and any long-term attempt to deal with our budgetary crisis must begin with reform of our entitlement programs.

Thank you very much.

[The prepared statement of Pat Toomey follows:]

PREPARED STATEMENT OF HON. PATRICK J. TOOMEY PRESIDENT, CLUB FOR GROWTH, FORMER REPRESENTATIVE IN CONGRESS FROM THE STATE OF PENNSYLVANIA

Mr. Chairman and members of the committee, thank you for inviting me. I am pleased to be here today to offer my views on the effects of reestablishing statutory PAYGO rules.

Supporters of PAYGO have long argued that PAYGO rules are necessary to reduce the federal deficit. At the outset let me say that reducing the deficit is a well-intentioned objective. That said, subjecting tax cuts to the PAYGO rule—as the Majority's proposal does—may actually take us farther away from that goal instead of bringing us closer to it, and in the process, do great harm to American prosperity.

Subjecting tax cuts to PAYGO rules will not only sound the death knell for future tax cuts, but will also result in the largest tax increase in American history. While it is technically possible to extend the current tax rates in compliance with PAYGO rules, it is clear that there is no appetite for the reduced mandatory spending that would be required. The resulting huge tax hike will not go unnoticed by the American economy. An economic downturn may well result, which could lead to a decline in federal tax revenue, leading, in turn, to much larger deficits than the path we are currently on.

Opponents of tax cuts have long resisted the inextricable connection between tax cuts and economic growth. But even a brief look at the economic benefits of the 2003 tax cuts suggests that any rule that precludes their extension and instead forces a reversion to prior, higher rates will likely have the unfortunate effect of inhibiting economic growth in this country.

A simple before and after picture does the trick. The before picture is as grey and grim as the after picture is bright. Consider the following numbers:

- Two years before the 2003 tax relief was implemented, American workers lost 2.7 million jobs—at an average of 100,000 jobs lost per months. Two years after the 2003 tax cuts, the American economy gained 4.3 million new jobs, an average of 160,000 per month. Today, we have gained over 8 million jobs since August 2003, and the economy continues to create jobs at a similar rate.
- In 2001, Gross Domestic Product growth was at a meager 1.1%. Two years after the tax cuts, GDP growth was at 3.8%.

- At the time of the 2003 tax cuts, the unemployment rate was at 6.1%. Two years after the cuts, unemployment sank to 5.1% and currently sits at 4.5%.
- Prior to the tax relief, business investment had declined for eight straight quarters. After the tax relief, it increased for 15 straight quarters, and continues to climb today.
- Since the 2003 tax cuts, the Dow Jones Industrial Average has increased nearly 80%, recently hitting a record-breaking level of 14,000.
- Capital gains income has increased by 153.3% since the end of 2002.
- In 2005, capital gains income was $604 billion, just $11 billion below the all-time high set during the boom in the late 1990's.
- In 2005, dividend cash payments grew by more than 11%, marking the third straight year of double digit growth of S&P 500 dividend income.
- Dividend income ended 2005 at a record level of $154 billion.

Specifically, the tax cuts on capital gains and dividends earnings in 2003 have been a huge boon for shareholders, according to the IRS. Consider these numbers:

Clearly, the 2003 tax cuts have played a large role in the increased economic growth in this country. But the story does not end there. Increased economic growth contributes directly to increased revenue and therefore, a reduction in the federal deficit. While opponents of the tax cuts argued (and continue to argue) that we could not afford the decrease in federal revenue resulting from the tax cuts, we saw huge revenue increases very shortly after the tax cuts were implemented, and tax revenues continue to flow into the federal coffers at an astonishing rate. Again, a quick before and after picture is instructive.

After declining from 2000 to 2003, federal tax revenue surged in 2004, 2005, and 2006. In 2004 and 2005, revenues grew by 14.6% and 11.8% respectively. To understand just how remarkable these numbers are consider that 2005 marks the first time since the mid1980's (following the Reagan tax cuts) that our nation has generated double-digit revenue growth in consecutive years. Fortunately, this positive trend is continuing today. For the first eight months of 2007, incoming tax revenue has already increased by 6.9%.

Despite the preponderance of evidence to the contrary, opponents of tax cuts have a habit of leaning on the Congressional Budget Office projections to argue the magnitude of revenue losses that will result from tax cuts. But this is like a cripple leaning on a faulty crutch. If there is one thing that is clear from the past four years it is the CBO's inability to accurately project revenue. Consider the following numbers:

- In 2004, the CBO projected tax revenues to increase by 2%, compared with an actual increase of 5.5%
- In 2005, the CBO projected tax revenues to increase by 9.4%, compared with an actual increase of 14.6%.
- In 2006, the CBO projected tax revenues to increase by 7.4%, compared with an actual increase of 11.8%.
- In 2007, the CBO projected tax revenues to increase by 5.6%. Thus far, revenues are up by 6.9%.

Worse, the CBO radically underestimated the government's revenue intake from capital gains earnings after the 2003 tax cuts. At the time, dire warnings about the price of the cuts rang through these very halls. Instead of witnessing the fulfillment of those warnings, we have witnessed a sharp increase in revenue from capital gains—far beyond what the Joint Committee on Taxation and the Congressional Budget Office predicted.

In January of 2004, the CBO forecasted capital gains revenue to be $42 billion for 2003; $46 billion for 2004; $52 billion for 2005; and $57 billion for 2006. Actual returns were significantly higher: $51 billion in 2003; $72 billion in 2004; $97 billion in 2005; and $110 billion in 2006. In total, the CBO's forecast on capital gains revenue for 2003-2006 was off by a staggering 68%. Clearly, if we are in need of an economic projector, history has a better track record than the CBO.

The aforementioned numbers are clear and stark. It is no coincidence that federal tax revenue from capital gains earnings shot up immediately after the tax rate was lowered dramatically. Opponents of the capital gains tax cuts focused on the decreasing tax rates and assumed that tax revenue would follow suit. This is far too simplistic of an equation. Revenue taken into government is not solely dependent on the tax rates we impose, but on the tax rates as applied to income. If you broaden income by lowering rates, revenue can increase.

Of course, increased federal revenue—all else held constant—must result in a shrinking deficit. As revenue continues to flow into the federal government's coffers, the Congressional Budget Office and the Office of Management and Budget have been forced to significantly revise downward their deficit projections for 2004-2006, citing robust growth and revenues as a large reason for their revisions.

- In 2004, the OMB projected a deficit of $521 billion. The actual deficit was $412 billion, a decrease of $109 billion, or 21%.
- In 2005, the OMB projected a deficit of $427 billion. The actual deficit was $318 billion, a decrease of $109 billion, or 25%.
- For 2006, the OMB originally projected a deficit of $423.3 billion. The actual deficit was $247.7 billion, a reduction of $175.6 billion, or 41%.
- For 2006, the CBO originally predicted a deficit of $371 billion. The actual deficit was a reduction of 33%.

The relationship between tax cuts, economic growth, revenue, and the deficit are clear. Subjecting tax cuts to PAYGO rules effectively severs this relationship at the head by removing the very catalyst that helps the economy grow. If the purpose of PAYGO is to decrease the deficit—or at least hold it at bay—then ruling out future tax cuts and imposing the largest tax increase in American history is the wrong path to take. Rather than decrease the federal deficit, the Majority's PAYGO rules may actually exacerbate the very problem the Majority is trying to solve. Instead, PAYGO rules could be tantamount to legislating economic disaster.

Ultimately, the problem with the Majority's PAYGO rules is that it treats tax cuts and new government spending as equivalent. Supporters of this proposal assume that the tax cuts will cost the government a set number of dollars just like a new government program. This outlook is predicated on a static view of the world that is patently wrong. The economy is not static, but a dynamic creature. As I have demonstrated above, new tax cuts (if they are done properly) expand economic activity and can result in an actual increase in new government revenue and a reduction in the deficit. The same cannot be said for new government spending which does not (except sometimes briefly) expand economic growth—and can even have the effect of retarding it—and results in decreased revenue and an increased deficit.

But a broader point must be made about focusing excessively on budget deficits. While shrinking the federal deficit is important, it is not crucial as an end in itself, but only to the extent that it serves as a means to another end—increasing prosperity and economic growth. At the end of the day, job growth, higher incomes, and gains in family wealth are more important than the number on the federal government's ledger.

Some will argue that deficits contribute directly to the rate of economic growth and are therefore worthy of being elevated to such a high priority. Proponents of this argument claim that excessive government borrowing crowds out private borrowing and drives up interest rates, thus retarding economic growth. This can be true, but the operative word in this argument is "excessive."

A brief stroll down memory lane demonstrates the hollowness of this fear in the near term. Over the past five years, the U.S. government went from surpluses to deficits, but the interest rates tumbled at the same time. The reason for this is simple. Interest rates are driven primarily by other factors. Certainly, truly excessive debt has the potential to boost interest rates and harm economic growth, but we are far from approaching this worst-case scenario. It is important to remember that the current deficit is only 1.5% of the Gross Domestic Product and decreasing by the day.

What really matters is not the absolute size of the deficit but the size of the deficit as a percentage of the economy. This is true in most facets of life. Consider the following simple scenario: An elderly man dies, leaving his son two businesses from which to choose his inheritance. The first business is worth $500,000 and carries no debt. The second is worth $10 million, but carries $1 million in debt. Clearly, the second business is the better choice. The point of this little anecdote is that the size of the debt doesn't tell us the whole story. While no one likes debt, its presence out of context should not be the decisive factor in setting economic policy.

Finally, the real budgetary crisis facing our federal government isn't addressed by PAYGO. The real crisis is unsustainable projected growth in entitlement spending in absolute dollars and as a percentage of GDP.

While PAYGO is a well-intentioned rule, its implementation should not come at the cost of preventing economy-stimulating tax cuts, and any long-term attempt to deal with our budgetary crisis must begin with reform of our entitlement programs.

Thank you again for allowing me to comment on this important issue.

Chairman SPRATT. Go next to Mr. Bixby and then, Ms. MacGuineas, we will let you be the cleanup hitter.

STATEMENT OF ROBERT L. BIXBY

Mr. BIXBY. Thank you very much, Mr. Spratt, Mr. Ryan, other members of the Committee.

I am here representing the Concord Coalition. And in our view, reinstating PAYGO in law would be a very positive step in restoring fiscal discipline and preventing the daunting long-term outlook from getting any worse. I think it would also encourage a necessary discussion of the tough choices that need to be made for a sustainable fiscal future.

I think it is important to note at the outset that while strong budget enforcement rules such as PAYGO can provide very positive incentives for fiscal discipline as has been stated, they are not a substitute for political will and PAYGO would not address the long-term problems that are on an unsustainable course right now, but that does not mean that we should not do it because it would help prevent the situation from getting any worse.

I want to begin by thanking you for having this discussion because there is a general feeling among the American people or there is a general feeling anyway that the American people do not care about this issue, that the eyes can glaze over. Actually, that is not the case.

As Comptroller General Walker has mentioned, we have been going around the country. The Concord Coalition has organized this fiscal wake-up tour that includes General Walker and people from Brookings and people from Heritage and we have been doing this for almost two years now. And we find that people are indeed very interested in this.

We have been to over 20 cities now. They understand the difficulty of the challenge. They understand the need to make sacrifices. What they do not understand is why all of us here in Washington are not able to deal with the problems.

But I would like to report that as you consider reestablishing statutory PAYGO, I think you can be encouraged by knowing that the public from our experience instinctively grasps the logic behind the rule. It is a common-sense concept that says that we must make choices to stop digging a bigger hole for future generations to fill in.

So my overall first point is that the public gets that. People understand that and I think that PAYGO has a public constituency out there.

I am not going to spend any time unusually talking about the long-term outlook because everybody has mentioned that. I will just say that I agree with the consensus from all sides that the future is unsustainable on the current path.

So what can budget process reforms do? Well, I would like to make a couple of points about PAYGO. I start with the premise again that, no, it does not do enough, but we do believe that it is important not to dig the hole any deeper.

PAYGO should definitely apply to both sides of the budget, that is to say we believe it should apply to both spending and revenue decisions. It goes best with a set of discretionary spending caps as it did in the original “Budget Enforcement Act.” That way, all sides of the budget have some sort of enforcement mechanism and nothing is exempt.

PAYGO should also have a credible threat, that is to say the sequestration element of PAYGO is very important. It is really what gives it its teeth and separates it from the rule that both the House and the Senate have adopted.

It is important for the sequestration threat to be credible, however, and I would urge you if you go this route to have a fairly broad base of programs. I would frankly make no exemptions. I am sure that that would not get too far because people would want to exempt Social Security and then you start down a road where what do you exempt and what do you not exempt.

The problem you get into is that if almost all of the mandatory side of the budget is exempt, then it makes it almost impossible to actually do a sequester because the consequences are too toxic. So the broader the base, the more credible the threat, I would think, and the fairer the threat because it would be spread more broadly.

I think that another point you are going to have to consider if you go this route is whether there should be any exemptions from PAYGO. I do not think that there should be. There is a former rule in the Senate that said that, you know, anything that was written into the budget rule would be exempt and that is one way of doing PAYGO.

Arguably that makes sense because you could say Congress would decide every year what it was prepared to do and then they would enforce that rather than just put a PAYGO requirement on everything.

The Concord Coalition has not favored that approached, however, and the reason why is that it is a huge exemption and it basically allows Congress to enact fiscally irresponsible policies simply by writing them into the budget resolution. So that does not really provide a whole lot of enforcement.

I think that if you, a final point on this, is that if you go this route, and I would say, by the way, that any sort of rule you have can be gimmicked. I mean, Congress has always has a capacity to you write the rules, you can change the rules. You can try to get around the rules. I do not think it is a reason not to adopt a strict PAYGO rule to say, well, you know, you can try gimmicks to get around it.

I think that the important thing is that if you have a statutory component to PAYGO, it is going to be more difficult to waive than the rule that exists now, particularly the House rule. And it is a backup because the House rule works differently and the Senate rule works differently.

With the statutory PAYGO, you would have a backup procedure at the end that would look at all of the actions on both the revenue side and the mandatory spending side and you would have that threat of sequestration hanging over the whole process. So it would complement and be a backup to what you have now, so I do not think it would be a redundancy in any sense.

My final point is that if you are going to do some new statutory PAYGO, I would consider including some long-term budget targets this time, not spending caps, not entitlement caps per se, but the Concord Coalition has made a suggestion about including sort of a long-term budget component and apply the PAYGO rule to that as well, and that might get into some of the look-back things that Comptroller General Walker was talking about so that it would bring existing mandatory spending programs within some sort of budget enforcement procedure.

Again, I would not talk about automatic triggers or cuts or anything like that, just a method of bringing everything into the tent and under the PAYGO rubric.

Thank you.

[The prepared statement of Robert L. Bixby follows:]

PREPARED STATEMENT OF ROBERT L. BIXBY, EXECUTIVE DIRECTOR, THE CONCORD COALITION

Chairman Spratt, Mr. Ryan and Members of the Committee, I am pleased to appear before you today to discuss the merits of strengthening the budget process by restoring statutory "pay-as-you-go" (PAYGO). In my view, reinstating PAYGO in law would be a very positive step in restoring fiscal discipline and preventing the daunting long-term outlook from getting any worse. It would also encourage a necessary discussion of the tough choices that must be made for a sustainable fiscal future.

I am here representing The Concord Coalition, a nonpartisan organization dedicated to strengthening the nation's long-term economic prospects through sound and sustainable fiscal policy. Concord's co-chairs are former senators, Warren B. Rudman (R-NH) and Bob Kerrey (D-NE). They, along with Concord's President former Commerce Secretary Peter G. Peterson and our nationwide membership, have consistently urged Washington policymakers to produce a credible plan for long-term fiscal sustainability.

It is important to note at the outset that while strong budget enforcement rules, such as PAYGO, can provide positive incentives for fiscally responsible action, they are not a substitute for political will. No strategy for fiscal sustainability will succeed over the long-term unless we find a way to reduce projected costs, particularly for health care. A realistic strategy will likely require some mix of spending reductions, and revenue increases—negotiated in a bipartisan process—aimed at preventing total spending, taxes or debt from reaching levels that could reduce economic growth and future standards of living.

In my remarks, I will begin with brief comments about the budget's long-term outlook, followed by a discussion of measures—such as PAYGO—that could assist the Congress in its efforts to restore and maintain fiscal discipline despite the economic and demographic pressures that confront the federal budget.

But first, I would like to thank you for undertaking this discussion. After all, the conventional wisdom is that the American people are largely indifferent to issues related the federal budget's long-term prospects. That is not an accurate assessment. For almost 2 years now, The Concord Coalition has undertaken a Fiscal Wake-Up Tour to talk to the American people about what is common knowledge in Washington D.C.—that current budget policies threaten the nation's future economic well-being.

United States Comptroller General David M. Walker, and experts from The Brookings Institution, the Heritage Foundation, and The Committee for Economic Development, have joined The Concord Coalition on the tour to explain the issues and to hear from communities across the country. As a result of visits to more than 20 cities, I can report to you that people understand the difficulty of the challenge and the need to make sacrifices. What they do not understand is why their elected leaders are not making adequate progress on solving the problems we face.

Members of the Fiscal Wake-Up Tour do not necessarily agree on the ideal levels of spending, taxes and debt, but we do agree on the following key points:

- Current fiscal policy is unsustainable
- There are no free lunch solutions, such as cutting waste fraud and abuse or growing our way out of the problem.
- Finding solutions will require bipartisan cooperation and a willingness to discuss all options.
- Public engagement and understanding is vital in finding solutions.
- This is not about numbers. It is a moral issue.

We do not recommend specific policy solutions. Indeed, we are upfront about the fact that we do not necessarily agree on solutions. However, we remind audiences that each of the realistic options comes with economic and political consequences that must be carefully weighed, and that there must be tradeoffs.

Those who want to raise taxes are asked to explain what level of taxation they are willing to support and the manner in which the new revenue should be raised.

Those who argue that spending must come down from projected levels are asked which programs they would target and how the savings would be achieved. Those who are unwilling to do either are asked how much debt they are willing to impose on future generations. I mention this because these are precisely the choices that you, as elected leaders, must face when making decisions under a PAYGO rule.

Our experience is that when audiences are told the facts, and shown that if they demand their "rights" to programs or policies it will have damaging economic effects to other groups or generations represented in the audience, they begin to accept the need for tradeoffs. In other words, as you explore the possibility of restoring statutory PAYGO, you can be encouraged by knowing that the public instinctively grasps the logic behind the rule. PAYGO is common sense concept. It says that we must make choices to stop digging a deeper hole for future generations to fill in. People understand that.

In addition to the Fiscal Wake-Up Tour, the same group of analysts from Concord, Heritage and Brookings have been working with Public Agenda and ViewPoint Learning, on a project designed to provide insight into how attitudes evolve as people discuss difficult trade-offs with regard to long-term fiscal policy. It is called "Facing Up to the Nation's Finances."

As part of this project, three intensive day-long "Choice Dialogues" have been conducted in San Diego, Kansas City, Philadelphia and in three locations in Tennessee. Public Agenda has released a report on these dialogues1 in which the following observations stand out:

- The public is strongly averse to big increases in the size of the national debt and, with the right kind of leadership, is prepared to accept sacrifices to avoid it.
- For most people, the overriding concern is not resistance to taxes but a profound lack of trust in government. People are willing to pay for what they want so long as they can be satisfied that government will spend the money wisely and for the purposes intended.
- Americans are willing to make changes in entitlements, but again on condition that trust and accountability exist.
- While there is continued strong support for defense spending, it is accompanied by the widespread perception that funds are misallocated and often wasted.
- Americans want to be engaged in addressing these issues and are frustrated by the lack of engagement that contributes to their mistrust of government

Both the Fiscal Wake-Up Tour and the Facing Up project will continue through 2008.

OBSERVATIONS ABOUT THE FEDERAL BUDGET'S PROSPECTS

The most recent analyses of the Congressional Budget Office, the Government Accountability Office, the Office of Management and Budget, and independent fiscal and economic policy experts consistently conclude that current budget policies are on an unsustainable path. Since many of those experts are available to you today, I do not need to spend much time on the projections aside from noting that The Concord Coalition joins with their consensus conclusion.

I would, however, like to make two observations to emphasize how important it is to address the imbalances in current budget policy. First, recent "good news" on the budget could be bad news if we use it to conclude that our problems are behind us, and second, nothing about the short-term improvement in the deficit represents a fundamental shift in the daunting long-term picture.

The good news may be bad news.

Clearly, there has been some good news on the budget front. In 2007, for the third year in a row, revenues are up and the deficit is down. So why are The Concord Coalition and others traveling around the country issuing a fiscal wake-up call? It's because we are not looking in the rear view mirror. We are looking ahead. And it doesn't take a crystal ball to see what's coming:

Our nation is undergoing an unprecedented demographic transformation against the backdrop of steadily rising health care costs and steadily falling national savings. It is a dangerous combination for the future health of the economy.

Consider three facts:

- Social Security, Medicare and Medicaid already comprise 40 percent of the federal budget. That is before the baby boomers begin to retire.
- Over the next 25 years, the number of Americans aged 65 and up is expected to nearly double, growing from 12 percent of the population to 20 percent. The ratio of workers paying into Social Security and Medicare relative to the number of beneficiaries will fall by roughly one-third.
- Demographic change, however, is only part of the problem. For the past 40 years health care spending has consistently grown faster than the economy. If the

same growth rate continues over the next 40 years, Medicare and Medicaid will absorb as much of our nation's economy as the entire federal budget does today.

It is true that CBO's baseline for fiscal years (FY) 2008-2017 projects declining deficits followed by budget surpluses in FY 2012 and thereafter. Moreover, the President has taken to the road to argue that under his budget policies the deficit would disappear by 2012. Taking these projections at face value produces a deceptively benign outlook.

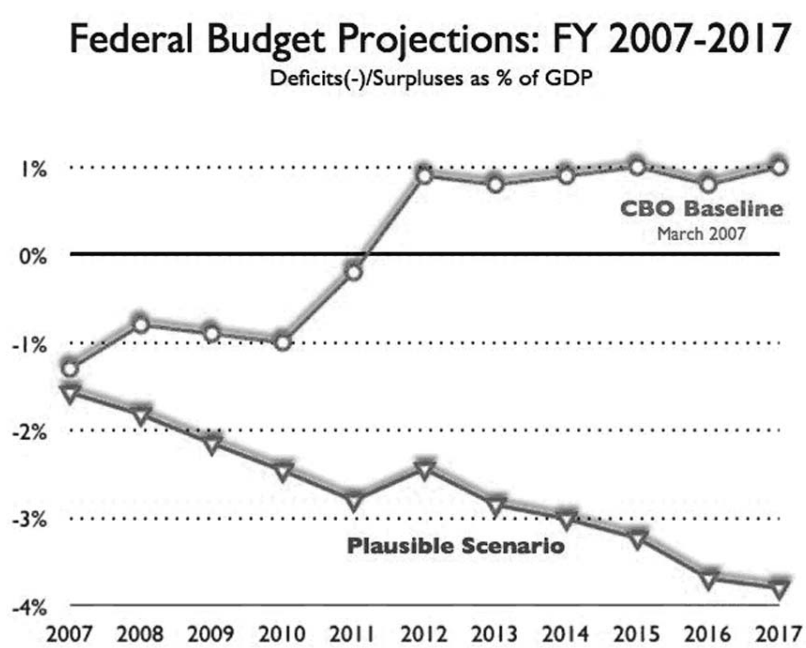
The "good news" could be bad news for fiscal discipline because it fosters an attitude of complacency. It makes worrying about long-term fiscal imbalance look as out of place as wearing a raincoat on a sunny day. In effect, the improved short-term fiscal outlook encourages higher spending and deeper revenue reductions—the very policy changes that negate the projected improvements to the bottom line of the budget.

A look back at the budget outlooks from 1999 to 2001 reminds us of how seductive good news can be. Baseline projections of surpluses "as far as the eye could see" kicked off a holiday from budget discipline that has yet to end. Despite CBO warnings that that the short-term projections of surpluses did not resolve long-term fiscal imbalances, spending increased at a faster pace than contained in those optimistic projections while tax cuts reduced revenues. Subsequent changes in the economy and threats to the nation's security at home and abroad significantly altered the budget's outlook without motivating a return to responsible fiscal posture.

The following chart (figure 1) illustrates a plausible alternative to CBO's current budget outlook. It assumes:

- Continue funding while gradually phasing down operations in Iraq and Afghanistan, reducing troops in those missions to 75,000 by 2013 and beyond;
- Extend all tax cuts expiring in FY 2007-2017;
- Index the alternative minimum tax for inflation; and
- Increase spending for regular discretionary programs at the same rate of growth as the economy.

FIGURE 1



Under that set of assumptions the deficit in 2017 would approach 4 percent of gross domestic product GDP instead of the surplus of 1 percent of GDP contained in CBO's baseline. Further erosion of the budget's bottom line would result if the PAYGO principal of budget neutrality contained in the FY 2008 Congressional Budget Resolution is not enforced as new authorizations for the State Child Health

Insurance Program (SCHIP), agricultural subsidies, tax cut extensions, and other programs are finalized.

The good times won't last.

Even if the CBO projections somehow turn out to be close to target, the growth in programs affected by the aging of the population will, under current laws, outpace the growth in the economy and revenues. If policy makers do not act to slow the growth in spending for Social Security, Medicare and Medicaid, to reduce spending on other programs or to increase revenues, financing the resulting fiscal gap—net interest costs—grows faster than any other category of the budget including Medicare and Medicaid. Recent analyses from the Government Accountability Office show that in 2050 net interest costs as a share of GDP could exceed Social Security, Medicare and Medicaid combined—obviously an unsustainable outcome.2 Those who say that deficits don't matter are not paying attention to interest costs. Even now, net interest is a bigger expense than the wars in Iraq and Afghanistan or the federal government's share of Medicaid.

The country has not yet reached a consensus over the question of whether projected spending is too high or projected revenues are too low. But there is no question that the projected gap between revenues and spending, and the resulting debt burden, would put our Nation's economic security in serious jeopardy and increase exposure to the uncertainty of global capital markets.

So far, there is little evidence that the bond markets are concerned about the potential borrowing needs of the United States government over the long-term—a "conundrum" as it is called by the Federal Reserve's former Chairman Alan Greenspan.

Long-term Treasury rates remain comfortably at or below levels seen throughout the last 40 years. That has prompted some to believe that the projected fiscal gap does not matter because an ample supply of willing lenders exists to fill the gap. The favorable interest rate conditions are likely to persist as long as the markets doubt, as appears to be the current case, the likelihood of serious federal deficits over the long-term. If, however, they have reason to question that assumption, the market's reaction could be swift and costly. There will be no forbearance as policy makers attempt to remedy the perception. Acting proactively—not waiting for markets to react—would allow a more gradual shift to the policy adjustments that will have to be made.

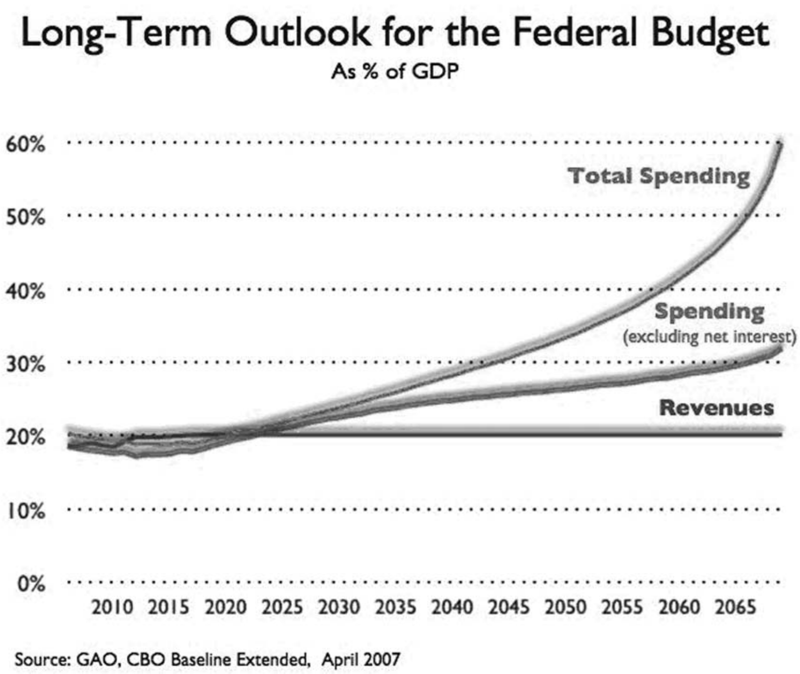
Global borrowing conditions in the coming decades almost certainly will be significantly different than they are today. The United States is not alone when it comes to long-term fiscal imbalances. Many other countries are facing similar pressures related to the aging of their populations. That implies an overall increase in resources required to support older populations that would put upward pressure on global interest rates. Indeed, the populations of many countries—China, Japan, Germany, France and the United Kingdom, for example—are aging more rapidly than our own. Those countries are among the largest holders of current Treasury debt. Many of those same countries provide more extensive public retirement and health benefits.

It is not possible to predict with any certainty whether future debt issued by the U.S. Treasury will retain its attractiveness to global lenders relative to other borrowers. There are some indications, however, that the U.S. may have greater potential risks that could affect borrowing costs. For example, within the European Union many governments are making progress towards addressing their own age-related fiscal imbalances through reforms for public pension programs, real asset accumulation, and greater attention to health care and long-term care programs.3

In addition, the United States starts at a significant disadvantage when it comes to containing future health care spending, which is the primary driver of escalating spending projections in the long-term budget. The United States already spends significantly more per capita than any other country, and health spending consumes a significantly larger share of GDP than in other countries with advanced economies (16 percent in 2006 compared to the 9 percent average for Organization for Economic Cooperation and Development countries).4 Moreover, the annual excess growth rate of real health care costs is roughly double that of the OECD (non-U.S.) average, indicating that health care could exert greater pressure on the U.S. economy and the budget than in other nations.5 Despite higher spending per capita health care, the U.S. does not achieve superior health outcomes (measured in terms of infant mortality, healthy life expectancy at age 60, etc.).6

The point is, whatever the world economy looks like two, three, four decades from now, the United States will have greater room to maneuver if it acts now to limit the growth in future debt levels. Today's apparent budgetary "good news" should not lull policy makers into believing that conditions cannot change. Hard as it is, adopting a more disciplined stance toward the budget will be easier now than later when the magnitude of required policy adjustment is likely to be greater and far more disruptive to the American people.

FIGURE 2



BUDGET PROCESS REFORM CAN HELP

The Concord Coalition strongly supports your efforts to strengthen the budget process. We have repeatedly urged the Congress and the President to return to the statutory rules enacted in the 1990 Budget Enforcement Act (BEA). Those measures set enforceable limits on discretionary spending and required that changes to entitlement spending and revenue provisions be deficit neutral—the pay-as-you-go, or PAYGO requirement. The BEA rules provided the fiscal discipline that helped to balance the budget in 1998 for the first time in nearly three decades. The lesson that can be learned from that overall success is that budget enforcement can be an important tool in achieving long-term budget goals.

REINSTATING PAYGO

The Concord Coalition encourages the House to adopt measures that strengthen its ability to enforce the budget. Reinstituting statutory PAYGO and limits on discretionary spending—both enforced through sequestration—would be a good beginning. Statutory PAYGO would put additional teeth into the PAYGO rule by establishing a mechanism that cannot be easily waived. In addition, because levels established in the Congressional Budget resolution would be written into law, it would force the Executive branch to play an earlier role in the congressional budget process.

We believe that reinstituting two-sided PAYGO, which incorporates both entitlement spending and tax policy changes, is an important first step towards restoring fiscal discipline. Not only does PAYGO help to keep the long-term outlook from getting worse, but it also forces explicit acknowledgement of the obvious—someone sometime will have to pay for deficit financed increases in entitlement spending and tax cuts, if not within the five to 10-year budget window, then sometime in the future through higher taxes or reduced federal programs, benefits and services.

Restoring a sense of fiscal discipline will be a very difficult challenge. It will be virtually impossible without strong budget enforcement mechanisms. There are too many claims on too few dollars to declare that formal budgetary restraints are no longer necessary. And while it cannot be said that either discretionary spending caps or PAYGO worked very well after 1998 when surpluses emerged, it is clear that protecting a surplus is not something we'll need to worry about in the near future. Sadly, the task at hand is to bring the deficit back under control. The track record for caps and PAYGO in times of big deficits is one of success.

There should be no wishful thinking that we will "grow our way" back to budget balance. Deficits are back for as far as the eye can see and they are likely to persist unless Congress and the President take specific steps to rein them in.

Unfortunately, quite the opposite has been happening in recent years. The political consensus that once existed in support of running a surplus excluding Social Security (i.e., an "on-budget" surplus) has broken down. Rather than setting priorities and making hard choices, Congress and the President have simultaneously increased spending and cut taxes—with little or no regard for how it all adds up.

It is worth noting in this regard, that the huge $5.6 trillion surplus projected just six years ago did not simply disappear because of changing economic projections. According to CBO estimates as of January 2007, legislation and its associated interest costs have consumed more than the entire amount. Economic and technical factors have reduced it by another $2 trillion—meaning that over the same timeframe, 2002 to 2011, we now have a projected deficit of $2 trillion instead of a projected $5.6 trillion surplus. If one looks at just the five-year window (2002-2006), which is no longer based on projections, the cost of new legislation (spending and taxes) exceeded the projected surplus by $200 billion. While it would not be fair to attribute the breakdown in fiscal discipline entirely to the end of statutory PAYGO, certainly the absence of this rule has been a major factor.

Some have argued that limiting PAYGO to spending would focus enforcement on the elements of the budget that are the source of long-term fiscal woes—that is, entitlement programs in general and Social Security, Medicare and Medicaid in particular. Those programs are of particular concern because they will grow as the population ages and health care costs continue to outpace economic growth. Together they will comprise larger and larger shares of the budget reducing the share of resources available for all other programs and putting upward pressure on taxes (see figure 3).

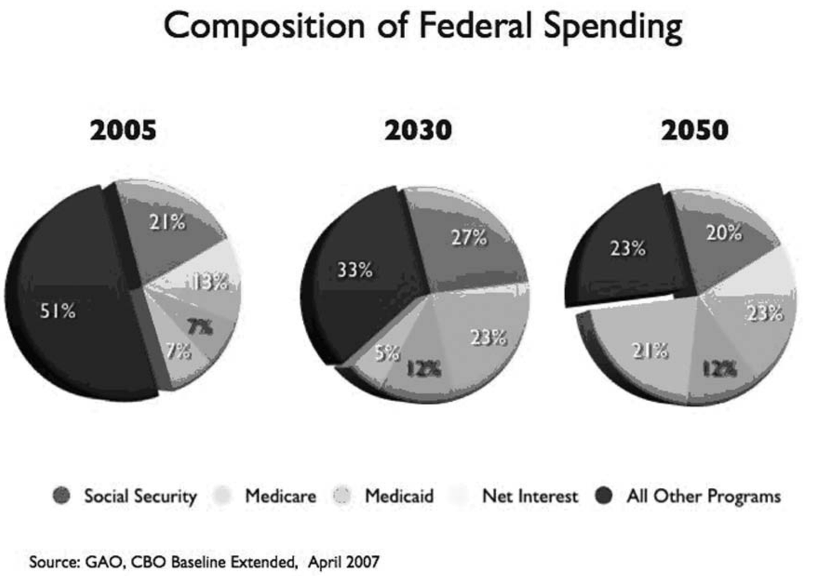
As the number of beneficiaries increases, Social Security's growth is projected to be modest (about 2 percent of GDP). Health care entitlements are the source of deeper concern. They are projected to grow faster than the growth in eligible beneficiaries and the economy.

The Concord Coalition has long maintained that it would be a mistake to isolate spending from revenue decisions through the application of PAYGO to spending alone. Budgeting is a process of allocating resources that requires trade-offs, not only among competing spending priorities but also between spending and revenue objectives. Spending and tax decisions both affect overall budget deficits or surpluses. Exempting tax decisions risks encouraging the expansion of so-called "tax entitlements" (where benefits are funneled through the tax code rather than through direct spending) whose benefits are difficult to target and evaluate in terms of effectiveness and performance. In addition, subjecting tax changes to PAYGO provides balance to budget deliberations by subjecting those who stand to benefit from tax changes to the same level of scrutiny as beneficiaries of entitlement changes. Finally, of concern to advocates of limited government, exempting tax cuts from PAYGO fosters the false notion that government services are "free." Debt is not a painless alternative to taxation.

Many key issues would need to be addressed in restoring statutory PAYGO. For example, Congress should formally decide whether, or how, the rule should apply to projected surpluses, a point left vague by the former law. Another issue is whether there should be exemptions. For example, the Senate's former PAYGO rule exempted policies assumed in the budget resolution. Arguably, such a rule could provide appropriate flexibility, but in practice limiting PAYGO to those policies not assumed in the budget resolution provides little incentive for fiscal discipline. It essentially allows Congress to enact fiscally irresponsible policies by simply assuming them in the budget resolution. That is a loophole much too tempting to permit—even if proposed in good faith.

It would also be important to design and enforce strict rules about emergency exemptions. As for sequestration, it would be important to provide the widest possible base. The fact that popular programs many be threatened by sequestration is what gives PAYGO its punch. If the burden of sequestration falls on too narrow of a base the resulting cuts may prove too toxic to enforce. There must be a credible threat that is uncomfortable, but plausible.

FIGURE 3



BEYOND PAYGO: CONFRONTING THE LONG-TERM FISCAL IMBALANCE

Statutory PAYGO would help enforce budget discipline in the near term. Addressing the projected long-term fiscal gaps, however, will take other measures. PAYGO is designed to keep long-term imbalances from getting worse, not to make them better. As discussed earlier, maintaining the status quo leads to deficits and debt that spiral upward and out of control.

Ideally, a new bipartisan fiscal policy agreement should be reached along with PAYGO. After all, the original PAYGO law came out of the 1990 bipartisan budget negotiations between President George H.W. Bush and the Democratic Congress. Such a new agreement would enact budget procedures that would promote closure of the long-term gap projected to arise between spending and revenues. At present, however, proposals for a budget agreement or enforceable measures to close the long-term gap are more conceptual than practical and controversial within the budget community. In any case, there is little political appetite for such measures.

But the fact that more needs to be done is not an excuse for doing nothing. The choice for policymakers is whether to reclaim a measure of fiscal discipline through the budget process while a more substantive plan is negotiated, or to sit by while deficits drift higher in the absence of any procedural hurdles designed to rein them in.

In Concord's view the choice is clear. We believe that reinstating strong budget enforcement rules, such as PAYGO, is the best step that can be taken immediately to stop digging the fiscal hole deeper.

While this would be a positive step, it falls short of addressing the central long-term budget challenge, which is constraining the cost of existing entitlement programs. PAYGO requires Congress to offset the cost of new programs or expansions of existing programs. It does not apply to current-law benefits.

In fact, there is nothing in the budget process that requires Congress to review the current-law budget outlook beyond the next ten years, much less take corrective action.

The current budget process encourages short-term thinking by focusing on a 5 or 10-year window. Yet, as analysts from all sides generally agree, our truly unsustainable fiscal problem stems from commitments that extend far into the future. Congress could greatly improve the transparency of our future obligations and encourage actions to deal with them by including in the budget resolution targets and estimates of major policy proposals stretching out for at least 40 years.

A five or ten year budget window may have been adequate back when most federal spending was appropriated annually. It is insufficient when most of the budget consists of entitlement programs set on a rising autopilot. It's time to include the long term in the budget process. In that regard, I believe the legislative recommendations (Transparency in Accounting and Budgeting) made by United States Comptroller General David M. Walker provide an excellent framework.

At a minimum, The Concord Coalition believes that lawmakers should have available to them clear and explicit information about the potential long-term consequences of proposed legislation that would expand major entitlement programs or reduce taxes. We have proposed an approach that would inject that long-term outlook for the budget into the annual budget process. It makes no pretense of compulsion, but by providing a formal means for the Congress to confront long-term projections would lead to constructive adjustments to entitlement and tax policies.

In our proposal, Congress should establish long-term targets for revenues and outlays by major spending category as part of the annual budget resolution. It should note how major legislative proposals assumed in the resolution would affect these targets and how the targets differ, if at all, from current law as projected by the CBO. Separate targets could be established, as a share of GDP at five-year intervals through 2040, for total revenues, defense spending, domestic discretionary spending, Social Security, Medicare, Medicaid, other entitlements, and net interest. If the targets differ from current-law projections, CBO could be required to issue a report with an illustrative menu of reform options capable of generating the proposed savings. 7

Compelling Congress to go on record about its long-term budget priorities, would focus the public (and Congress itself) on the nature of the choices before us—and so might pave the way for lasting reform.

The Concord Coalition proposal is forward looking. It empowers lawmakers by assigning them with an explicit responsibility of evaluating and planning for the future. It charges elected officials with developing strategic vision for the nation. If some leaders want to leave revenue levels alone, they would present a plan specifying what measures they would propose to spending or to finance any resulting fiscal gap. If other leaders want to maintain or expand current-law entitlements, they would present a plan for financing their proposals. The CBO options would put a concrete face on the types of measures that will be necessary, thereby helping to educate the public about the size of the problems we face and the real-life implications of necessary adjustments.8

CONCLUSION

Given the difficulty of the challenges presented by long-term budget projections, it is not surprising that little progress has been achieved. New budget rules alone will not solve the problem. Across-the-board sequestration is not a desirable means for addressing deficits. But enforceable budget rules focus attention on the bottom line numbers and thereby engineer a debate over the substantive policy issues that are at the root of long-term budget woes.

When budget experts discuss the intricacies of an effective PAYGO rule or craft a sequestration threat that is onerous enough to compel congressional avoidance of a rule violation, we tend to forget that this is not just a technical debate over an obscure internal governmental process. Public participants in the Fiscal Wake-Up Tour understand that continued inaction on the long-term challenges in the budget and increases the amount of uncertainty about standards of living for themselves and their families in the future. They do not understand why their elected officials, for whom the long-term budget outlook is old news, are not doing something about it.

Although budget rules alone will never be able to solve the nation's fiscal problems, enforcement mechanisms can bring greater accountability to the budget process and help provide Members of Congress with the political cover to make the tough choices necessary to reduce the deficit. Pay-as-you-go rules (PAYGO) for all tax and entitlement legislation is a proven tool for fiscal discipline.

Yet, no budget rules will be effective if they are not accompanied by a commitment to enforce them. Thus, it is critical that Congress resist the pressure to weaken them by exempting politically popular items, assuming additional costs in the baseline or routinely circumventing them with scorekeeping gimmicks when they become inconvenient. This will require policymakers to set priorities and make compromises among competing needs. Many tax and spending initiatives will need to be scaled back to fit within the amount of available offsets. The Concord Coalition would welcome the opportunity to work with you to develop practical approaches to encouraging long-term budget sustainability.

Thank you for your attention. I would be happy to answer any of your questions

ENDNOTES

[1] See, "It's Time to Pay Our Bills," *http://www.facingup.org/about-us/new-report-its-time-pay-our-bills*

[2] See, GAO, Long-term Simulation Data, Alternative Simulation at *http://www.gao.gov/special.pubs/longterm/april2007altsimulation.pdf*

[3] See Directorate-General for Economic Affairs, The Long-Term Sustainability of Public Finance in the European Union, October 2006, *http://ec.europa.eu/economy—finance/publications/european—economy/2006/ee0406sustainability—en.htm.*

[4] OECD Health Data 2007, July 2007, *http://www.oecd.org/document/16/0,3343,en—2825—495642—2085200—1—1—1—1,00.html.*

[5] Chapin White, "Health Care Spending Growth: How Different Is the United States from the Rest of the OECD?" in Health Affairs, May/June 2006.

[6] Cathy Schoen, Karen Davis, Sabrina K.H. How and Stephen C. Schoenbaum, "U.S. Health System Performance: A National Scorecard" in Health Affairs, November/December 2006.

[7] See, Concord Coalition Facing Facts Quarterly, December 2006, "Beyond Paygo: How to Encourage Long-Term Fiscal Discipline," by Richard Jackson.

[8] CBO is developing important analytic capability that eventually will allow it to assess in greater detail potential impacts of policy changes over the long term. Requiring the agency to develop long-term budget options would likely require additional analytic resources. The additional resources have the potential to expand understanding of the long-term budget implications of policy proposals—a result that will be sorely needed as policy makers address long-term challenges.

Chairman SPRATT. Now we go to Maya MacGuineas from the Committee for a Responsible Budget and the floor is yours to wrap it all up. Thank you for coming.

STATEMENT OF MAYA MACGUINEAS

Ms. MACGUINEAS. Good morning. Thank you.

The bipartisan Committee for a Responsible Federal Budget whose co-chairs are Bill Frenzel and Leanne Pinetta and many of whose members seem to be staring down at me from the walls around here believe that statutory PAYGO and tight caps on discretionary spending were instrumental in confronting the fiscal challenges of the 1990s and we believe they should be reinstated to help address the challenges today.

We encourage a strengthening of PAYGO including reinstating statutory PAYGO to make the principles more consistent, transparent, and effective. I will touch upon some of the possible improvements and I discuss this in more dept in my written testimony.

We strongly support dual-sided PAYGO. If PAYGO is not applied to both sides of the budget, there is a stronger incentive than there already is to run spending programs through the tax code further distorting our already disastrous tax base.

This organizational position is unrelated to our position on extending the tax cuts and our board is actually quite divided on this question. Some of our board members favor extending all or most of the tax cuts. Some of them favor extending some or none of the tax cuts.

But as a group, we believe that tax cuts should not be exempt from fiscal controls. And it is worth pointing out that for those who would like to control the growth of government, as many of our board members would, offsetting tax cuts with spending reductions should be seen as a desirable policy, not a problematic one.

Second, timing issues. Many tax cut and spending proposals have relatively modest cost in the shorter-term budget windows but have much larger longer-term costs which are not subject to limits. PAYGO should be structured to cover the long-term costs as well.

And on the flip slide, some proposals with near-term costs could be justified on the basis that they produce longer-term saving.

Addressing these timing issues involves complex questions about how to measure longer-term costs on savings of legislation and increasing uncertainty of estimates over time, we would suggest further studying these issues.

We believe the treatment of taxes and entitlements should be equalized. The most straightforward approach is probably to build the cost of major tax cuts and entitlement programs into the baseline requiring that all long-term costs be offset when the legislation is created even if the program is assumed to sunset.

A related issue is whether there is a way to require that if a policy ends up costing more than it was originally projected to, the additional costs should have to be offset.

Other changes. If statutory PAYGO is reinstated, there are a number of improvements that should be made. We would suggest broadening the sequestration base. It should be made more difficult to suspend sequestration or wipe the score card clean. We should be vigilant about what counts as emergency spending and we should require that separate votes be taken to exempt legislation from PAYGO requirements, making these choices more transparent.

So, finally, PAYGO could actually be strengthened to encourage action to improve the fiscal situation, not just keep it from deteriorating.

For instance, we could enact a form of a super PAYGO that would kick in when the deficit and/or unfunded liabilities reach a certain point, requiring that new costs both be offset and paired with some level of deficit or unfunded liability reductions. There are a lot of ways to be creative as we look forward to PAYGO for the future and the new challenges that we face.

The concept of PAYGO represents the simple truism that budgeting is about tradeoffs. We commend Congress for bringing the PAYGO principle back to budgeting. We hope they will maintain it throughout this budget cycle.

We recognize the challenges in doing so, but the stakes are high and we fear that a break in the resolve to live by the PAYGO principle will open up the floodgate for debt finance policy requests.

The bottom line is that PAYGO in any form is only as good as the commitment of legislators to follow it. We look forward to working with all of you to strengthen the requirements as well as the underlying commitment to the important principle.

Thank you.

[The prepared statement of Maya MacGuineas follows:]

PREPARED STATEMENT OF MAYA C. MACGUINEAS, PRESIDENT, COMMITTEE FOR A RESPONSIBLE FEDERAL BUDGET

Good morning, Mr. Chairman and Members of the Committee. I have been asked to comment on the merits of reestablishing the statutory PAYGO law. Thank you for the opportunity to testify. It is a privilege to appear before this Committee.

I am the President of the Committee for a Responsible Federal Budget. Our Co-Chairs are Bill Frenzel and Leon Panetta and our Board is composed of past Directors of the Office of Management and Budget, the Congressional Budget Office, and Chairs of the Federal Reserve Board and the Budget Committees. Our focus is the federal budget and related process issues. I am also the Director of the Fiscal Policy Program at the New America Foundation, a non-partisan think tank here in Washington D.C.

The Committee for a Responsible Federal Budget has a long-standing record of supporting the budget reforms in the Budget Enforcement Act of 1990. We believe that statutory PAYGO and tight caps on discretionary spending were instrumental in confronting our fiscal challenges in the 1990s and we believe they should be reinstated to help address the challenges we face today. We also support a number of other budget process reforms detailed in our report, Federal Budget Process: Recommendations for Reform at *http://www.crfb.org/pdf/2000/RecommendationforReform.pdf.* We will be publishing a new options book on budget process reform in the coming months.

A clear starting point for us is that budget deficits do matter. They affect the economy, they affect budgetary flexibility, they affect future standards of living, and they affect generational equity. The Congressional Budget Office's projections show the debt held by the public growing by $450 billion over the next three years. Considering where we are in the business cycle, the amount of debt we have accumulated in past years, and the looming retirement of the baby boomers, this is an unacceptable additional burden that we should not be entering into. We should be looking at paying down the national debt, not running it up. Furthermore, we face imbalances of trillions of dollars in Social Security and Medicare, our two largest entitlement programs. We should be using every fiscal tool we can find in the tool box to help meet these challenges.

The reinstatement of PAYGO—in any form—is a great first step. Clearly, PAYGO will not by itself balance the budget or address our long-term fiscal challenges, but it will help to bring discipline back to the budgeting process. PAYGO puts the breaks on policies that increase the deficit and it provides hurdles Congress has to clear before enacting new mandatory spending or tax cut policies. We commend the new Congress for bringing the PAYGO principle back to budgeting, and we hope they will maintain it throughout this budget cycle. We recognize the challenge of doing so, but the stakes are high and we fear that a break in the resolve to live by the PAYGO principle will open a floodgate of debt-financed policy requests.

The concept of PAYGO represents the simple truism that budgeting is about trade-offs. PAYGO requires that Congress identify the means for offsetting the costs of new tax cuts or mandatory spending programs, thereby allowing Congress the flexibility to implement the policies it chooses along with the responsibility of paying for those policies.

Statutory PAYGO was originally introduced in the bipartisan budget agreement of 1990. It was extended in the bipartisan balanced budget agreement of 1997 and remained in effect through 2002. PAYGO was successful in large part because it represented an agreement by both parties to only advance their policy priorities in a fiscally responsible way in exchange for the other side agreeing to do the same.

Unfortunately, PAYGO was a victim of its own success, as the surpluses that it generated weakened the resolve of Congress to offset new spending and tax changes. Since the expiration of statutory PAYGO, both the House and the Senate have introduced PAYGO rules (the House just recently.) While they operate in a similar manner, statutory PAYGO and a PAYGO rule are not the same. Both forms of PAYGO stipulate that an increase in mandatory spending or a decrease in taxes must be offset by an equal decrease in mandatory spending and/or increase in taxes, so that the legislation does not increase the deficit. The differences arise in the way PAYGO is enacted, enforced, and waived. (One-sided PAYGO and post-policy PAYGO obviously differ from the statutory PAYGO of the 1990s in other significant ways as well.)

Statutory PAYGO applies the same rules to the House and Senate and is agreed to by the President. This type of PAYGO is binding, and is enforced by the Congressional Budget Office. Under statutory PAYGO, changes to tax or entitlement programs that increase the deficit trigger across-the-board sequestration in certain mandatory spending programs. Each individual bill does not have to balance, but changes have to balance out over the session. If balance is not maintained, automatic reductions to rebalance the budget are required. Though there were no sequesters in the 1990s, the threat of the blunt reductions affected policy choices and helped to control the deficit.

PAYGO rules lack the force and the breadth of statutory PAYGO. The rules apply individually to each chamber and do not bind the other. They establish parliamentary points of order that must be raised by a Member to take effect. To suspend them, only the chamber to which they apply must approve. The rules in each House and Senate can be quite different. Currently, the PAYGO rules in the House and Senate differ in that the Senate relies on a scorecard and allows offsets to be carried over from one bill to another, while the House does not. Also, for PAYGO to be waived in the House, the Rules Committee must make and pass a specific rule exempting the piece of legislation at issue from PAYGO requirements; in the Senate, 60 Senators must vote to exempt the bill and overturn the point of order—a release lever that we greatly fear will be used all too regularly.

The Committee for a Responsible Federal Budget encourages a strengthening of PAYGO in any way that would help make the principles more consistent, transparent, and effective. This includes, but is not restricted to reintroducing statutory PAYGO. It is helpful to have identical restrictions operating in both the House and Senate. The two Chambers should not have to spend their time negotiating PAYGO differences at the expense of working on key budget issues such as determining national priorities and finding responsible ways to enact and oversee related policies. To keep Congress and the White House from operating on different tracks, it is also useful to have a statute to which both Congress and the President have agreed. Statutory PAYGO also has the advantage of being self-enforcing. There are always ways to get around the law, many of which were employed in the past, but statutory PAYGO makes the restriction harder to bypass. The threat of a sequester certainly makes Congress think twice about failing to offset the costs of new policies.

Statutory PAYGO is desirable because of its consistency between both chambers and the White House, the default mechanisms that it utilizes, and the added difficulty of ignoring the law. At the same time, there are important improvements that could and should be made to the design of PAYGO.

Dual-Sided PAYGO—Recently, there has been a good deal of disagreement over whether PAYGO should apply to both spending and taxes or just spending. The Committee for a Responsible Federal Budget has strongly supported dual-sided PAYGO in the past and continues to believe that a balanced form of PAYGO is a critical component of ensuring budget discipline. It is necessary to apply PAYGO to both sides of the budget—taxes and spending—otherwise there will be stronger incentives than there already are to run spending programs through the tax code in order to avoid the requirement of offsetting the costs. One merely needs to look at the moth-eaten tax base to see that spending by means of the tax code is already overused.[1] Furthermore, the lack of balance in a one-sided PAYGO system stymies the widespread political buy-in from both parties that is needed to make PAYGO an enduring and effective instrument of fiscal discipline.

Timing Issues—It is critical that opportunities to end-run PAYGO be eliminated or at least reduced to the extent they can be. The longer a rule exists, the smarter those who want to break it get at finding ways to do so. PAYGO is no exception. With regards to timing, many tax cut and spending proposals have relatively modest costs within the shorter-term budget windows covered by PAYGO rules, but have much larger long-term costs, which are not subject to limits. We recently saw an example where one tax cut was paid for by another due to timing anomalies. Allowing legislation with permanent costs to be offset by temporary savings that later turn into permanent costs clearly defeats the purpose of the principle. PAYGO should be structured to cover long-term costs as well as those that are more immediate. Now more than ever, given the long-term budget challenges we face, altering the rule so that long-run costs are covered is an important improvement.

On the flip side, some proposals with near-term costs could be justified on the basis that they will produce long-term savings. Some types of Social Security individual accounts that are paired with long-term savings, for instance, could be fiscally responsible, though they would not comply with the current versions of PAYGO. Addressing these complex timing issues involves several difficult questions about how to measure long-term costs and savings of legislation, the increasing uncertainty of cost estimates over time, and how to balance the relative certainty of near-term costs with the less certain prospects for long-term savings. We do not have all the answers to these important questions but we firmly believe that they need to be studied in order to improve PAYGO and close the loopholes that most seriously weaken it.

Balance Between Spending and Taxes—Some argue that PAYGO is biased against tax cuts because the presumption is that entitlement programs will continue—even if they are set to expire—but that tax cuts will expire as planned, and must then be offset if they are extended. The opposite side of this coin, however, is that entitlement programs are scored as though they will continue, making the original costs higher, while tax cuts can be made to look cheaper by truncating the policy time frame and assuming the savings associated with expiration. The major tax cuts created in 2001 and 2003 are expiring (and will have to be paid for if they are extended under PAYGO) because they were passed in a way that used a sunset provision to limit their original cost estimates.

We believe the treatment of taxes and entitlements should be equalized. The most straightforward approach would be to build the costs of major tax and entitlement

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[1] See "Closing the $700 Billion Tax Loophole" by Maya MacGuineas in Ten Big Ideas for a New America *http://www.newamerica.net/publications/policy/ten—big—ideas—for—a—new—america*

legislation into the baseline. This would mean that extending the policies would not "cost" anything or require future offsets, but it would be more costly to create the policy in the first place and would require long-term offsets even if the policy were slated to sunset. Including the costs of extending all policies that are likely to be reauthorized presents a more accurate picture of the fiscal future. A related issue is whether there is a way to require that if a policy ends up costing more than is originally projected, the additional costs would have to be offset. We think this would be desirable for both tax and spending policies.

Our policy position on PAYGO as an organization is unrelated to our personal positions about extending the tax cuts. Our Board is divided on this question: some would make permanent most or all of the tax cuts, others would extend only a few or none of them. But as a group, we believe that tax cuts should not be exempt from fiscal controls. It is worth pointing out that for those who would like to control the growth of government spending—as many of our Board Members would, offsetting tax cuts with spending reductions should be seen as a desirable policy, not a problematic one.

Other Changes—If statutory PAYGO is reinstated, there are a number of improvements that should be made. We should broaden the sequestration base. Too many programs have been made exempt. Since the exempt programs are generally the most popular, this defangs sequestration and it increases the severity of the cuts that would have to be applied to the remaining programs. Also, when statutory PAYGO was in place, Congress regularly intervened in order to prevent sequesters. By passing legislation, it removed the balances on the scorecard in 1999 and every year thereafter that the law was in effect.[2] It should be made more difficult to suspend sequestration or wipe the scorecard clean to circumvent PAYGO. Additionally, Congress tried to use directed scorekeeping to circumvent the law by directing OMB to score legislation so that it did not affect the PAYGO scorecard. Though these attempts were not successful, in the future, directed scorekeeping should not be permitted.

Another avoidance tool Congress used was to stretch the definition of "emergency spending" to include things that certainly were not, as a means of avoiding PAYGO restrictions. This abuse coincided with the general eruption of the use of the emergency designation to circumvent budget rules. Congress needs to tighten up and enforce the definition of emergency spending to keep this blatant abuses from happening in the future. Finally, to improve transparency, we should require that separate votes be taken to exempt legislation from PAYGO requirements.

We are in a worse fiscal position then we were in when PAYGO was first enacted. The deficit as a share of GDP is not as problematic, but the long-term problems are far worse—exacerbated in large part by policies enacted while PAYGO was not in place—and the retirement of the baby boomers is much closer. An important question is whether PAYGO could be strengthened so that it does not just keep things from getting worse, but rather is designed to encourage, and when necessary, force action to improve the fiscal situation. This could take many forms, but one I will propose is that when the deficit and/or unfunded liability numbers reach a certain point as a share of GDP, perhaps a "Super PAYGO" that would require new costs to both be offset and paired with some level of deficit or unfunded liability reduction, would kick in.

The bottom line is that PAYGO in any form is only as good as the commitment legislators have to following it. Congress should not pass PAYGO requirements, declare victory, and then spend its time attempting to bypass the intent of the principle. Too often process is used as a replacement for the hard choices when it is really only one step of many. Process will never on its own be able to do the heavy lifting of rebalancing the budget.

Nonetheless, PAYGO has a number of desirable benefits. It is based on the common sense principle that we should pay for what we spend. This is something the public believes and Congress should support. PAYGO has a bipartisan pedigree—it was the product of a bipartisan agreement in 1990, was included in the Democratic budget in 1993, and the Republican budget in 1995, and was extended in 1997 with the support of both parties. It allows Congress the flexibility to pass the legislation it wants as long as the costs are offset, enforcing the notion that budgeting is, and should be, about tradeoffs between national priorities. The statutory form of PAYGO is stronger and, given its solid track record and the need for fiscal discipline, it should be reinstated, albeit with some technical changes to make it more effective and balanced. The rules established by the Budget Enforcement Act made a significant contribution to bringing the deficits under control in the 1990s and we

[2] The first three waivers were passed in Conference Reports for omnibus appropriations while the fourth was passed as a freestanding bill.

urge Congress to move forward with legislation reinstating these statutory budget rules. We applaud Congress for returning to a pay-as-you-go era and we look forward to working with all of you to strengthen the requirements, as well as the underlying commitment to this important principle.

Chairman SPRATT. Thank you very much.

And now I am going to yield my time to Mr. Moore as the sponsor of legislation on the Committee and be the baseline we start with when we sit down to draw up some legislation.

And let me further say to all of you what you testified to today will be helpful to us as we try to craft a new rule. Thank you very much for your input.

And let us go to Mr. Moore.

Mr. MOORE. The panel members, thank you for being here and for your testimony.

Were you here and heard the testimony of Dr. Orszag and Mr. Walker, please, all of you?

Mr. TOOMEY. Yes.

Mr. MOORE. I would ask, Mr. Toomey, you heard the response to my question about are all tax cuts created equally. Did you disagree with their answers, Mr. Toomey?

Mr. TOOMEY. No. We believe strongly that all tax cuts are not created equally.

Mr. MOORE. Okay. And, for example, repeal of the estate tax, is that going to pay for itself?

Mr. TOOMEY. Probably not. I do not recall that I have seen an analysis on that itself.

Mr. MOORE. Is it correct or do you understand it to be correct that in the past six years, the national debt of our country has increased about $3 trillion?

Mr. TOOMEY. Well, it depends on what you are talking about by the national debt. I think the only meaningful national debt really are two. One is the actual obligation of the government to other people. Intergovernmental borrowings and lendings should be netted out.

And the other one is the big unfunded liability of the big entitlement programs. So I am not sure which of those you are referring.

Mr. MOORE. Well, at the time, about six years ago, as I recall, I believe this is correct, I believe the national debt stood at about 5.7 or $5.8 trillion and now it is over $8.8 trillion. Do you disagree with that?

Mr. TOOMEY. I would just observe that that includes the intergovernmental borrowings. And if I lend myself money, that is neither an asset nor a liability. So that is not as meaningful as the 4.9 trillion which is the real obligation to other lenders and the 50 trillion unfunded liability of our entitlement programs.

Mr. MOORE. When were the last surpluses in the past, say, 15, 20 years?

Mr. TOOMEY. Late 1990s, around 2000.

Mr. MOORE. And that was when we had PAYGO; is that correct?

Mr. TOOMEY. That is correct.

Mr. MOORE. All right. And as soon as PAYGO expired, we started having deficits; did we not?

Mr. TOOMEY. Of course we had some very calamitous events occur in the interim as well including September 11th and an economic recession and some very, very significant budgetary impacts.

Mr. MOORE. And do you really expect that we are going to get back into a balanced budget unless PAYGO is reinstituted?

Mr. TOOMEY. I hope we could, but I think it is going to be a function of if and when Congress and the President jointly agree to restrain spending. You know, for a brief and glorious time in the 1990s, there was that absolutely historically unprecedented boom in investment and innovations that really were on par with the Industrial Revolution when we had the whole internet and the technology sector which was a tremendous driver of the economy and revenue. Those are unusual times.

Mr. MOORE. Did you see Congress Daily yesterday and the article that I referred to when I talked to Mr. Orszag, Dr. Orszag?

Mr. TOOMEY. I did not.

Mr. MOORE. All right. I want to read you just the first two paragraphs. A new analysis by the nonpartisan CBO found that projected budget deficits would have largely been wiped out and possibly turned into surpluses had it not been for President Bush's 2001 and 2003 tax cuts.

In addition, quote, the overall impact of the tax legislation on the economy is likely to be modest, end quote, said the analysis released late Friday.

Would you agree or disagree with that?

Mr. TOOMEY. Well, I would disagree with that and I am not sure how they would square that with the fact that back in 2003 prior to the tax cuts, the revenue that they were projecting for this year, for instance, and for last year was less than what is actually coming in this year and last year.

Mr. MOORE. But we still have deficits this year and last year; is that right?

Mr. TOOMEY. Yes. My point is, though, they were projecting that without the Bush tax cuts, they would have been larger or at least the revenue would have been less. So who knows what spending would have occurred. That is obviously the other part of the equation.

Mr. MOORE. You said all tax cuts are not created equally.

Mr. TOOMEY. Right.

Mr. MOORE. Which ones do you think contribute to deficits and debt?

Mr. TOOMEY. Well, the way we look at it is there are some tax cuts that generate greater economic growth and if they generate more economic growth, they expand the base upon which taxes are applied and, therefore, can generate more revenue.

In particular, we think the most pro-growth tax cuts are those which lower marginal tax rates on work, savings, investment. Lower marginal tax rates increases the incentive to engage in all of those activities and you get more of them. That leads to the stronger economy and ultimately greater revenue.

Using the tax code to target benefits on narrow groups, for instance, is not at all conducive to economic growth and that kind of tax cut, if one calls it that, we tend to frown upon.

Mr. MOORE. Thank you.

I yield back, Mr. Chairman.

Chairman SPRATT. We will turn now to Mr. Ryan and then we will save a few minutes for questions on this side to wrap it up.

Mr. Ryan.

Mr. RYAN. We have a vote, so that is why I think we are going to be—I will do this fast.

Boy, there is a lot I could go into all of this. Let me first start with the current House SCHIP Expansion Bill, it is my understanding proposes doing away with the Medicare 45 percent trigger.

Let me just ask from Bixby and down to Mr. Toomey, do you think that is a good idea to repeal the Medicare 45 percent trigger?

Mr. BIXBY. I do not. I think that some sort of trigger should be in place. If the general revenue trigger is not a good idea, then I think that somebody should come up with something to replace. But, no, I would not favor just simply repealing it.

Mr. RYAN. Mr. Greenstein.

Mr. GREENSTEIN. I do favor repealing it. The 45 percent trigger, I think, is very distortionary. I do think there is an argument for some sort of a trigger, but I think the 45 percent trigger is so badly designed that it is actually worse than having no trigger at all.

Ms. MACGUINEAS. We do not favor repealing it. We think that there is a whole lot of use for triggers in the future and we hope we will see more of them in the budget.

I would recommend triggers that kick in usually when spending is a share of GDP is probably a better way to craft them. But I think getting rid of it would be a huge step in the wrong direction and we will be hoping and working with members to keep that trigger in place.

Mr. TOOMEY. We do not favor repeal of the trigger. We just heard about the enormous costs that accelerating healthcare costs are imposing on the economy and the government and this is a mechanism, however flawed, to at least trying to address that.

Mr. RYAN. Well, I guess three out of four is not so bad.

This is one of the little speed bumps we have that says, whoa, let us pause and take note of the fact that Medicare is on an unsustainable path, that it is growing out of control.

And the idea that we will remove just this little bump in the road, this little pause to get Congress to think seriously about entitlement reform, to me, would just be a huge step in the wrong direction which unfortunately I believe this will be passed on to the Ways and Means Committee tomorrow, I believe, is the intention.

Since we have just a few minutes left, I will not take up my full five because I know Marcy wants to ask a question.

I will simply say when we think about PAYGO, for instance, for the record, and I think this needs to be settled, in 2004, we had a vote on PAYGO. It was one-sided as people described this, PAYGO on spending with discretionary spending caps. And the votes were 146 Republicans were in favor of it, 72 Republicans were opposed to it, most of whom came from the Appropriations Committee. And all Democrats were opposed to it.

So even putting part PAYGO extension and discretionary spending caps when we had the vote on the floor three years ago, it failed.

I would simply say that we have agreement, I think in this room, on at least discretionary spending caps. Why do we not bring a bill to the floor with discretionary spending caps. All of us, I think, agree on just that.

So maybe we have a disagreement on PAYGO. I will not go through that argument. We have what we think are good arguments. You have what you think are good arguments. But I think if you go over through this Committee, you will probably have unanimous agreement, maybe two or three people opposed to it, that we should have discretionary spending caps. So why do we not move forward with that? And that is just an appeal I would like to make to my colleagues.

Chairman SPRATT. Well, I mentioned a minute ago, look at what we are spending for defense, $50 billion in the base defense budget and $140 billion in the war supplemental. Accommodating that under any kind of cap is going to be very awkward to do and it would probably have to be fixed from time to time such as to make the cap meaningless. Let us go on. We will have that debate again.

Mr. RYAN. Well, I will not take any more time because I know we have to vote.

Chairman SPRATT. Anyone on our side who would in particular like to pose a question at this point? Mr. Edwards, Ms. Schwartz?

Mr. EDWARDS. I do not want to keep anybody from missing the vote. Do we know how many minutes we have left?

Chairman SPRATT. We have got eight and a fraction.

Mr. EDWARDS. Very quickly, Mr. Greenstein. As I understand it, we always have economic growth when we are coming out of recession. I have also seen numbers that indicated the economic growth coming out of the recession of 2000 has been slower than the economic growth coming out of the recessions for the past 40 years in this country. That might undermine to some degree the comments made by our former colleague, Mr. Toomey, about it was the tax cuts that created economic growth.

Any insights on economic growth coming out of this last recession compared to other recessions where we did not have these trillion dollar tax cuts?

Mr. GREENSTEIN. We have looked at how this recovery has compared on seven basic measures, GDP growth, net investment growth, jobs and salaries, et cetera, et cetera. What you find is that on six of seven, everything except corporate profits, the growth in the current recession is below the average for all other recovery since the end of World War II. And it compares unfavorably with the comparable phase of the 1990's recovery which actually followed a tax increase.

So I do not think there is an argument to be made there in terms of the economic effects of the tax cuts enacted earlier in the decade.

One more quick comment on tax cuts and this is about Mr. Ryan's question on the 45 percent trigger. Part of my real objection to the 45 percent Medicare trigger is that under that trigger, you can cut Medicare beneficiaries and you can raise payroll tax rates on workers to help meet the trigger, but you are not allowed to deal with tax preferences that General Walker talked about. You would not be allowed to deal with excesses, for example, in healthcare tax preferences. I think there is something wrong with a trigger that says payroll tax rate increases are okay and closing tax preferences is not allowed and that is why I think it should be repealed.

Chairman SPRATT. Thank you very much.

We have to rush through the conclusion, but we assure you we will consider the legislation and what you have left. And we thank you very much.

I ask unanimous consent that all members be allowed to submit an opening statement for the record at this point if they have not had an opportunity to make one. And I ask unanimous consent that members who did not have the opportunity to ask questions may submit questions for the record within seven days.

The Committee is now adjourned.

[Whereupon, at 12:36 p.m., the Committee was adjourned.]

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