STATUTORY PAYGO

HEARING

BEFORE THE

COMMITTEE ON THE BUDGET
HOUSE OF REPRESENTATIVES

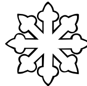
ONE HUNDRED ELEVENTH CONGRESS

FIRST SESSION

HEARING HELD IN WASHINGTON, DC, JUNE 25, 2009

Serial No. 111–13

Printed for the use of the Committee on the Budget



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50–917 PDF WASHINGTON : 2010

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STATUTORY PAYGO

THURSDAY, JUNE 25, 2009

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

The committee met, pursuant to call, at 10:01 a.m. in room 210, Cannon House Office Building, Hon. John Spratt [chairman of the committee] presiding.

Present: Representatives Spratt, Schwartz, Becerra, Doggett, Berry, Boyd, McCollum, Melancon, DeLauro, Edwards, Scott, Langevin, Larsen, Bishop, Schrader, Ryan, Hensarling, Garrett, Diaz-Balart, Lummis, and Latta.

Chairman SPRATT. I think more of the committee will be joining us later in the morning. But in the interest of time, I think we should also get this hearing started.

The purpose of this hearing is to review statutory Pay-As-You-Go, PAYGO, and examine the President's proposal to renew it. Initially, we had planned this hearing for last Thursday; and I would like to thank both of our witnesses and our ranking member, Mr. Ryan, for their cooperation in helping us reschedule it for today.

At the outset of the 1990s, Congress passed the Budget Enforcement Act to ensure that the Budget Summit Agreement was carried out. Among its provisions was a rule that we colloquially called Pay-As-You-Go, PAYGO for short. Our critics disdained our resort to budget process. They accused us of dodging the hard choices we had to make if we were going to wipe out the deficit. But by the end of the 1990s, the budget was in surplus for the first time in 30 years; and it was clear that process rules like PAYGO played a big part in our success.

Republicans were in the majority in 2002 when the BEA expired. They chose not to reinstate PAYGO, knowing it would impede passage of their tax cut agenda. Without the process rules, the budget plunged from a surplus of $236 billion in the year 2000 to a deficit of $413 billion in the year 2004.

When Democrats took back the House, the reinstatement of PAYGO was on the top of our agenda. We made PAYGO the rule of the House the first day we convened the 110th Congress.

Two weeks ago, the President proposed a bill to make PAYGO statutory; and last week that bill was introduced, with over 150 cosponsors, as a starting point toward making statutory PAYGO part of our budget process.

The Obama administration and the current Congress have inherited a colossal deficit, swollen this year to accommodate needed recovery measures. As these measures help pull us out of the slump,

we need to refocus our attention on the longer-term fiscal fate of this country and this government.

Earlier this month, Chairman Bernanke told our committee that the long-run fiscal path is simply not sustainable; and witness after witness comes to us bearing the same message. Statutory PAYGO works because it reins in new entitlement spending and new tax cuts. Both tend to be long lasting. They are easy to pass and hard to repeal. By insisting on offsets and deficit neutrality, PAYGO buffers the bottom line. Its terms are complex, but at its core is a common-sense rule that everyone can understand: When you are in a hole, stop digging.

We share the administration's commitment to fiscal discipline and believe that statutory PAYGO will put greater rigor into the budgetary process.

To help us understand the proposed legislation, our first witness will be no stranger to this committee. He is a former CBO Director, now the OMB Director, Peter Orszag.

Then, on our second panel, we have lined up additional experts who are old friends of the Budget Committee as well: Robert Greenstein from the Center on Budget and Policy Priorities; Doug Holtz-Eakin, who is also a previous Director of CBO.

We originally planned for Alice Rivlin to testify. She was not able to be here due to the schedule change. If there is no objection, we will make her statement part of the record.

Before turning to Director Orszag for his testimony, let me turn to Mr. Ryan for any opening statement that he may wish to make. Mr. Ryan.

[The statement of Mr. Spratt follows:]

PREPARED STATEMENT OF JOHN M. SPRATT, JR., CHAIRMAN, HOUSE COMMITTEE ON THE BUDGET

The purpose of today's hearing is to review statutory Pay-As-You-Go (PAYGO) and examine the President's proposal to renew it. We initially had planned this hearing for last Thursday and I would like to thank both our witnesses and our Ranking Member, Mr. Ryan, for their cooperation in helping us reschedule it for today.

At the outset of the 1990s, Congress passed the Budget Enforcement Act to ensure that the Budget Summit Agreement was carried out. Among its provisions was a rule called 'pay-as-you-go' or PAYGO for short. Critics disdained our resort to budget process. They accused us of dodging the hard choices we had to make if we were going to wipe out the deficit. But by the end of the 1990s, the budget was in surplus for the first time in 30 years; and it was clear that process rules like PAYGO played a big part in our success.

Republicans were in the majority in 2002 when the Budget Enforcement Act expired, and they chose not to reinstate PAYGO, knowing that it would impede passage of their tax cutting agenda. Without the process rules, the budget plunged from a surplus of $236 billion in the year 2000 to a deficit of $413 billion in the year 2004.

When Democrats took back the House, the reinstatement of PAYGO was at the top of our agenda. We made PAYGO a rule of the House the first day we convened the 110th Congress.

Two weeks ago, the President proposed a bill to make PAYGO statutory, and last week that bill was introduced—with over 150 co-sponsors—as a starting point toward making statutory PAYGO part of our budget process.

The Obama Administration and the current Congress have inherited a colossal deficit, swollen this year to accommodate needed recovery measures. As these measures pull us out of the slump, we must focus attention on our longer-term fiscal fate. Earlier this month, Chairman Bernanke told our Budget Committee that the long-run fiscal path is simply not sustainable.

Statutory PAYGO works because it reins in new entitlement spending and new tax cuts. Both tend to be long lasting—easy to pass, hard to repeal. By insisting on offsets and deficit neutrality, PAYGO buffers the bottom-line. Its terms are complex, but at its core, it is a common-sense rule that everyone can understand: when you are in a hole, stop digging.

We share the Administration's commitment to fiscal discipline, and believe that statutory PAYGO will put greater rigor into the budget process. To help us better understand the proposed legislation, our first witness will be no stranger to this Committee, former CBO Director and now OMB Director Peter Orszag. Then, on a second panel, we have lined up additional distinguished experts who are also old friends of the Budget Committee:

- Robert Greenstein is the founder and Executive Director of the Center on Budget and Policy Priorities and provides expertise on a wide range of budget policies.
- Douglas Holtz-Eakin, served as the sixth director of CBO and also worked with George H. W. Bush and George W. Bush on economic policy.
- We had originally planned for Alice Rivlin to testify, as well, but with the schedule change for the hearing, she cannot be with us in person today, but, without objection, her written testimony will be included as part of the record. As you know, she is senior fellow at the Brookings Institution and formerly served as director of OMB during the Clinton Administration and also as director of CBO from 1975 through 1983, at the onset of our current budget process.

Before turning to Director Orszag for his testimony, however, let me turn to Mr. Ryan for any opening statement he may wish to make.

Mr. RYAN. Thank you, Chairman. And Budget Director Orszag, welcome back. Nice to have you here.

First, I want to note that I appreciate any real effort by the administration and Congress to get a grip on our Nation's mounting fiscal crisis. But when I look at the broader budgetary context that has developed in the first 6 months of this administration, I am afraid that this PAYGO debate is little more than a distraction. The President's budget will produce record deficits as far as the eye can see. Deficits never fall below $600 billion and hit $1.2 trillion by the end of the budget window; and, under this budget, the national debt will nearly triple over the next decade.

Second, after signing a bloated 2009 omnibus spending bill, a stimulus bill that will cost more than $1 trillion with interest costs and proposing an 11 percent increase in nondefense discretionary spending for this year alone, the administration is now demanding that Congress rush through a huge new entitlement program under the slogan of health care reform. Just this week, Treasury had to issue a record $104 billion in new debt to support all of this spending.

Not surprisingly, polls have started to show the public's concern about this deluge in spending and debt that Washington is racking up. So we get a Cabinet meeting to highlight $100 million in savings, followed by, a few weeks later, by a day-long media blitz to trumpet this PAYGO bill.

Clearly, both of these efforts were intended to give the impression that the administration is finally putting its foot down on out-of-control spending. But if you read the papers after either of these announcements, you will know that I am not the only one with skepticism. Even the Washington Post said that the President doesn't deserve much credit for his PAYGO proposal because of, quote, his failure to adjust his spending plans to budgetary reality, end quote.

But, notwithstanding all of that, there are some aspects of this bill that are real improvements to the House majority's existing rule. Most notably, the administration's proposal would modify

PAYGO so that simply preventing one unintended tax hike, such as the expansion of the AMT or expiration of the 2001 and 2003 tax laws, don't result in yet another unintended tax hike.

The administration's proposal would also direct CBO and OMB to ignore the all-too-often-employed timing shift gimmick, the practice of shifting spending or revenue from one year to the next in order to claim it as a savings.

Regrettably, these positive aspects will likely be overwhelmed by the basic but significant shortcomings of this bill.

First, there are no caps on annual appropriations, which make up 40 percent of the total spending. PAYGO in the past has always been accompanied by discretionary spending caps, and that has been the critical element of spending control. But the administration didn't do that.

Second, emergency spending is also exempt.

Third, PAYGO can easily be circumvented through gimmicks such as artificial reductions in spending that we saw recently in the SCHIP bill that met PAYGO by assuming that funding will be cut by 65 percent in 2014.

But, most important, PAYGO does nothing to address our greatest challenge to our long-term budgetary and fiscal health, the entitlement crisis that is already speeding towards us.

So while I certainly appreciate any genuine effort to fiscal discipline, I don't think it is wise to pretend that we can substitute a PAYGO slogan for the real, immediate action needed to get spending deficits and debt under control. I hope we can move this legislation toward the budget reforms that actually tackle the real fiscal problems we face; and I will assure both the chairman and the director that, when they are ready, I will be the first in line to help bring about that result.

Thank you, Chairman.

Chairman SPRATT. Thank you, Mr. Ryan.

Let me ask unanimous consent that all members be allowed to submit an opening statement in the record at this point.

Without objection, so ordered.

And let me say once again, welcome to our witness. We appreciate your coming and your endeavors to put this bill together and we will make your written testimony part of the record so that you can summarize it.

The floor is yours, Dr. Orszag. Thank you for coming.

STATEMENT OF PETER R. ORSZAG, DIRECTOR OF THE OFFICE OF MANAGEMENT AND BUDGET

Mr. ORSZAG. Mr. Chairman, Mr. Ryan, members of the committee, thank you for the opportunity to testify this morning on the Statutory Pay As You Go Act of 2009.

Largely because of rising health care costs, the Nation is on an unsustainable fiscal course. Given the large structural deficits that the Nation faces, we should follow the Hippocratic Oath that reminds doctors to first do no harm.

With respect to taxes and entitlement, the PAYGO Act is the statutory embodiment of that time-tested principle. It tells Congress and the administration that their minimum duty is not to

make the existing multiyear structural deficit any worse than it already is.

The PAYGO act would hold us to a simple but important rule: We should pay for new tax or entitlement legislation. Creating a new tax cut or entitlement expansion would require offsetting revenue increases or spending reductions.

In the 1990s, statutory PAYGO encouraged the tough choices to help move the Nation from large deficits to surpluses; and I believe it can play a similarly constructive role today. The statutory PAYGO legislation would complement existing congressional rules. Both houses of Congress have already taken an important step by adopting rules incorporating the PAYGO principle, but we can strengthen enforcement and redouble our commitment by enacting the PAYGO Act into law, which would allow us to adopt a belt-and-suspenders approach to fiscal discipline with the statutory PAYGO Act working alongside the existing rules.

How would it work? Under the PAYGO Act, OMB would maintain a PAYGO ledger recording the average 10-year budget effects of any legislation enacted through 2013 that affects government receipts or mandatory outlays relative to the baseline. We would sum the average cost of savings—costs or savings of all PAYGO legislation having effects in a given year and would record a net cost for that year if the cost exceeded the savings, which would then violate the PAYGO Act's budget constraint.

The PAYGO Act would enforce that budget constraint through the threat of sequestration. If policymakers don't make the hard choices necessary to pay for any new mandatory spending or tax reductions, the law would trigger sequestration, automatic cuts in nonexempt mandatory programs. Sequestration would strongly encourage all of us never to violate that PAYGO constraint because—and, therefore, in practice it would be a threat and not a reality. And the reason is that the across-the-board reductions for the programs that are covered would be so painful that, in the 1990s, that threat was significant enough to avoid its ever having to be triggered.

Now, as I have said, the proposed legislation would require that new mandatory or tax policy be paid for. That is the embodiment of the do-no-harm principle. A keyword here, however, is "new".

We have put forward a statutory PAYGO Act that reflects the thrust of current policy in three main areas: the sustainable growth rate formula for how doctors are reimbursed under Medicare, the 2001 and 2003 tax legislation, and the alternative minimum tax. In all three areas, we have adopted a current policy as opposed to a current law approach; and I would be happy to discuss that further during the question and answer period.

But the motivation in doing so was to avoid waiving the rules when current policy was extended in a way that there are no plausible offsets to pay for. And so we thought it was better to have a set of rules that could actually be enforced and that would not be waived, rather than having something that looked better on paper but then would immediately be waived in practice in major pieces of legislation.

Let me just conclude by noting that the current debate over health care reform illustrates the importance of the PAYGO prin-

ciple. Some advocates may support health reform even if it expands the deficit. The administration does not share that perspective. Some may say that all we need to do is make the system more efficient in the long run and this will pay for health care reform. We agree that bending the health care cost curve over the long run is essential, but it is not enough. That is why we have put forward $950 billion in hard scoreable offsets to make sure that the legislation is deficit neutral not only over 10 years but also in the tenth year alone.

So just to reinforce the point, what we are saying is that health care reform must be deficit neutral using CBO scored, hard scoreable offsets over 10 years and in the tenth year.

And then, in addition to that—because if that is all we did, we would be expanding coverage in a fiscally responsible way but perpetuating a health care system that did not embody best practices across the entire country and that did not capture the opportunity to move towards a higher-quality, lower-cost system.

So in addition to expanding coverage in a fiscally responsible way and making sure the package as a whole is deficit neutral using CBO scoring over the next decade, we also firmly believe there are a series of changes that must be made involving health information technology, expanded patient center health research, changes in financial incentives towards quality, and changes in the process through which Medicare policy itself is set that will help us move towards a rapid-learning, higher-quality, lower-cost system over time.

Thank you very much, Mr. Chairman.

[The prepared statement of Peter Orszag follows:]

PREPARED STATEMENT OF PETER R. ORSZAG, DIRECTOR, OFFICE OF MANAGEMENT AND BUDGET

Chairman Spratt, Ranking Member Ryan, and Members of the Committee, thank you for giving me the opportunity to discuss the Statutory Pay-As-You-Go ("PAYGO") Act of 2009.

The PAYGO Act would hold us to a simple but important principle: we should pay for new tax or entitlement legislation. Creating a new non-emergency tax cut or entitlement expansion would require offsetting revenue increases or spending reductions. In the 1990s, statutory PAYGO encouraged the tough choices that helped move the Government from large deficits to surpluses, and I believe it can do the same today. Both houses of Congress have already taken an important step toward righting our fiscal course by adopting congressional rules incorporating the PAYGO principle. But we can strengthen enforcement and redouble our commitment by enacting the PAYGO Act into law.

Both the President's Budget and the Budget Resolution approved by the Congress would cut the deficit in half by the end of the Administration's first term, while laying a new foundation for sustained and widely shared economic growth through key investments in health, education, and clean energy. Even though more will ultimately be needed to restore fiscal responsibility, enacting statutory PAYGO would complement the efforts already initiated and represent an important step toward strengthening our budget process.

THE PAYGO PRINCIPLE

The Hippocratic Oath famously reminds doctors to, first, do no harm. Similarly, but more colloquially, Charlie Stenholm, the long-time Texas congressman and a founder of the Blue Dogs, often repeated what he called the "rule of holes": If you find yourself in a hole, stop digging. With respect to taxes and entitlements, the PAYGO Act is the statutory embodiment of these time-tested principles. It tells Congress and the Administration that their minimum duty is not to make the existing multiyear structural deficit any worse than it already is.

This may seem like a relatively easy rule to follow, but history suggests it is not. One way to see this is by looking at three relatively recent pieces of legislation that violated the PAYGO principle: the 2001 and 2003 income tax reductions, or EGTRRA and JGTRRA, and the Medicare Modernization Act of 2003, which created the Medicare Part D prescription drug benefit. None of these three pieces of tax and entitlement legislation was paid for in PAYGO terms. Each was permanent or intended to be permanent. And those three bills together increased the 75-year fiscal gap—the difference between sustainable and unsustainable budgets—by roughly 3 percent of GDP.[1] Since estimates of the long-term fiscal gap prepared by GAO, CBO, and other independent analysts place it at around 7 percent of GDP, those three violations of the PAYGO principle by themselves nearly doubled the long-term fiscal gap. The difference, then, between adhering to and violating PAYGO is not a question of few billion dollars around the edges—but rather can go to the heart of the nation's fiscal path.

HOW PAYGO WORKS

PAYGO Ledger

Under the PAYGO Act, the Office of Management and Budget (OMB) would maintain a PAYGO ledger recording the average ten-year budgetary effects of all legislation enacted through 2013 that affects governmental receipts or mandatory outlays relative to the baseline ("PAYGO legislation"). After recording the average ten-year budgetary effect for each piece of PAYGO legislation enacted in a given year, OMB would then sum the budgetary effect of all PAYGO legislation having effects in that year (including the effects of legislation enacted in prior years but after the enactment of this proposal) and would record a net cost (or debit) for that year if the sum is negative.

Spelling out a few of these features in greater detail:

- Sunset. The PAYGO Act would expire after five years, on December 31, 2013.
- PAYGO window. The PAYGO Act would measure the cost or savings of PAYGO legislation in the current year and over the next ten years.
- Averaging. For the budget year and any remaining years on the PAYGO ledger, the PAYGO Act would require OMB to enter the average ten-year budgetary effect—rather than the budgetary effect in each individual year—associated with any piece of PAYGO legislation. This means that the PAYGO ledger is designed to require budget neutrality across a time period rather than year-by-year.
- Scorecard neutrality. The PAYGO Act would not require that each piece of enacted PAYGO legislation be budget neutral by itself, but rather only that the averaged budgetary effects in a given year of all PAYGO legislation enacted since the proposal becomes effective be budget neutral.
- Look back. To take into account any budgetary effects of PAYGO legislation in the current year (i.e., the year that PAYGO legislation is enacted), the PAYGO Act includes a "look back" rule, which provides that any budgetary effects in the current year (i.e., the year of enactment) would be treated on the PAYGO ledger as if they were budgetary effects in the budget year (which is the year subsequent to the current year).
- Timing shifts. The PAYGO Act would not give any credit for savings created or costs avoided through a shift between year 10, which is inside the PAYGO window, and year 11, which is outside the window. This restriction would prevent any gaming of the PAYGO Act that would occur by hiding the budgetary costs of PAYGO legislation just outside the PAYGO window.
- Basis of estimates. The PAYGO Act stipulates that OMB would estimate the average ten-year budgetary effects of all PAYGO legislation on the basis of the economic and technical assumptions underlying the latest President's Budget and in conformance with the scorekeeping guidelines determined by OMB after consultation with the House and Senate Budget Committees and CBO.

Sequestration

The PAYGO Act enforces its budget constraint through the threat of sequestration. PAYGO forces policymakers to make the hard decisions necessary to pay for any new mandatory spending or tax reductions by triggering sequestration—automatic cuts in non-exempt mandatory programs—if they do not.

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[1] The estimate that the 2001 and 2003 tax cuts increased the fiscal gap by 2% of GDP includes as part of its cost the degree to which those tax cuts expanded the size of AMT relief, but does not include cost of AMT relief that would be part of current policy even if those two tax cuts had not been enacted.

Specifically, if there is a net cost on the PAYGO ledger for the upcoming year when Congress adjourns at the end of a session, the President is required to issue an order temporarily sequestering resources—sufficient to fully pay off the PAYGO debit—from non-exempt mandatory programs in the budget year. With the exceptions of Medicare and three additional, small health care accounts,[2] non-exempt mandatory programs would be cut by a uniform percent; Medicare could be cut by at most 4 percent. If a cut larger than 4 percent is needed to offset the debit on the PAYGO ledger, the uniform percentage cut to the other non-exempt mandatory programs would be increased so that the sequester of Medicare and the other non-exempt programs would together produce sufficient savings to offset the budget-year debit.

Following in the footsteps of statutory PAYGO from the 1990s, the proposed legislation would exempt most mandatory programs from sequester—programs such as Social Security, veterans' disability and related benefits, and major low-income entitlements such as Supplemental Security Income and Medicaid. The remaining sequestration base totals approximately $540 billion in fiscal year 2010 and includes programs such as Medicare, farm price supports, and a number of grants to states.

Set up in this way, sequestration strongly encourages policymakers never to violate the PAYGO budget constraint and trigger sequestration—in other words, sequestration is in practice a threat, not a remedy. The sequestration base is broad enough to produce significant savings in the event sequestration were triggered, but it is narrow enough that any such cuts would be painful to important constituencies. In the 1990s, this careful balance resulted in Congress never triggering sequestration and, instead, making the hard choices that PAYGO requires.

It's also important to recognize that being exempt from sequestration does not mean a program is exempt from the PAYGO budget constraint. The only mandatory or tax legislation that is outside the scope of the PAYGO Act is legislation dealing with the two programs that are off-budget by law: Social Security and the Postal Service Fund. Otherwise, new mandatory spending or tax reductions—irrespective of whether they relate to programs that are exempt from sequester—would have to be paid for in order to avoid triggering painful automatic cuts to the programs in the sequestration base.

ADJUSTING FOR CURRENT POLICY

As I have said, the proposed legislation would require that new mandatory or tax policy be paid for—essentially enforcing a "do no harm" fiscal principle. A key word here is "new."

To focus the PAYGO Act on applying a strict budget constraint only to new policy, the proposed legislation includes adjustments in four policy areas where current policy deviates substantially from current law: the Medicare sustainable growth rate formula (SGR), the estate tax, the Alternative Minimum Tax (AMT), and the 2001 and 2003 income tax reductions. In each of these areas, the policies currently in place are set to expire or substantially change in coming years in ways that unrealistically reduce costs or increase revenues—for instance, payments to doctors under Medicare are scheduled to be cut by about 21 percent next year under the SGR, and virtually all of the 2001 and the 2003 tax cuts are scheduled to expire at the end of 2010. For these four areas, where the law on the books does not reflect the realities of current policy, the PAYGO Act would not require a continuation of those policies to be paid for.

Some have criticized the Administration for designing the PAYGO Act to reflect current policy rather than current law in these areas. These critics, however, have provided no indication of how they would offset the costs of continuing current policy in these areas, and I have seen no credible proposals for such offsets. The most plausible result of applying the PAYGO Act to a continuation of these current policies would therefore be waivers of the statute in these cases. Such waivers would establish a harmful precedent that could undermine the statutory PAYGO regime and lead to waivers for new policy, allowing policymakers to avoid the PAYGO budget constraint.[3] The Administration therefore believes it is better to design stat-

[2] The three additional health care accounts excepted from a uniform percentage cut are community health centers, Indian health facilities, and Indian health services; each is capped at a maximum 2 percent cut.

[3] Note also that the PAYGO Act would not alter the existing congressional PAYGO rules. The Senate PAYGO rule would still apply to legislation that extended current policies; the House PAYGO rule, as provided in the Budget Resolution, would recognize limited exceptions for the continuation of current policy if statutory PAYGO were enacted.

utory PAYGO in a credible way to minimize the potential for waivers, and that is what our proposal does.

The PAYGO Act would give a time-limited window for continuing current policy without paying for it. At the end of 2010, the adjustment for current policy would expire, unless the President determines that legislation sufficiently consistent with current policy has not been enacted in any one or more of the relevant four areas—in which case the President can choose to continue the adjustment for one more year, until the end of 2011. Once the adjustment is no longer allowed, continuing current policy would have to be paid-for, like any other tax or mandatory policy.

COMPLEMENT TO EXISTING CONGRESSIONAL PAYGO RULES

Both the House and Senate adopted PAYGO rules in 2007. Congress should be commended for having done so, and this was a substantial improvement over the immediately prior years when no such rules existed. Nonetheless, the House and Senate rules lack the sequestration mechanism that would give teeth to the PAYGO Act. As a result, the Administration believes that, while the congressional rules are an important bulwark for fiscal discipline, putting PAYGO back into law will complement and strengthen the rules and help to bring us back to a more sustainable budget. In other words, to borrow an old cliché, we believe in a "belt-and-suspenders" approach to PAYGO budgeting, with the PAYGO Act and the House and Senate rules working alongside one another to achieve fiscal discipline in a mutually reinforcing way.

Moreover, the joint presence of PAYGO rules and a PAYGO law would essentially replicate the situation in the 1990s, when a Senate PAYGO rule coexisted with statutory PAYGO. Notably, during this period from 1990 to 1999, Congress did not just meet the PAYGO requirement of budget neutrality, but managed to exceed it with the enactment of tax and entitlement legislation that in fact reduced deficits. (Congress accomplished this feat even before counting the effects of the deficit-reduction packages enacted in 1990, 1993, and 1997, which were deliberately excluded from the PAYGO scorecard.) It is quite possible that Congress was able to reach this result of net budgetary savings during the 1990s because it had to meet the requirement of both congressional rules and statutory PAYGO.

CONCLUSION

The current debate over health care reform illustrates the importance of enacting the PAYGO Act and abiding by the "do no harm" fiscal principle, even as we seek to invest in areas that have too long been ignored.

Some advocates may support health reform even if it expands the deficit; the Administration does not share that perspective. Instead, the President is insistent that health reform be deficit neutral through scoreable offsets, and has put forward roughly $950 billion in Medicare and Medicaid savings and additional revenue for that purpose. Beyond the need to make deficits no worse in the medium term, it is also crucial that we enact game-changing proposals that will move the health system toward one in which best practices are more universal across the nation, rather than isolated in certain areas and hospitals within the United States. These game changers may not score immediately, but they hold the key to containing health care cost growth in the long term and should be included in the legislation for this purpose.

We should not waiver from the fiscal principle of "do no harm"—in health care reform or elsewhere in the budget. Enacting statutory PAYGO is another important step in holding us to this goal.

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

Just a few basic questions to start with.

In the past, the Budget Enforcement Act, for example, was enacted for 5 years because it matched the 5 years of the Budget Summit Agreement. Is there some particular reason you chose 5 years here? Would 10 years be applicable and acceptable to the Administration or even no term limits at all?

Mr. ORSZAG. We chose 5 years for the duration of the statutory PAYGO Act just to mimic what was done in 1990 and then, frankly, done subsequently during the 1990s. But we don't have any firm principle. And maybe I should have said at the beginning, wherever possible, we were trying to recreate what existed in 1990. Since that was initially created for 5 years, we just said, okay, let

us do this for 5 years, also. We would have no objection to a longer time period.

Chairman SPRATT. In addition, you averaged the entries on the scorecard ledger, a little odd when you first read the proposal. Would you explain why you proposed to average it instead of actually making the entries when they occur?

Mr. ORSZAG. Yeah. The motivation there was that we had heard some concern from congressional staff that your existing rules in both the House and Senate look at it in a long-time period. They look at a 6-year time period and an 11-year time period and that if we had a statutory PAYGO rule that was year by year you would be creating inconsistencies between the congressional rule and the statutory act.

So we thought it was better to just simply reflect the same principle that you already have in your PAYGO rule in the House, which is look over, for example, a 10 or 11 year period. And if the thing is balanced over that window, then it meets PAYGO. The same principle would apply under statutory PAYGO.

Chairman SPRATT. There is another anomaly; and that is, to implement the new PAYGO, we first have to declare it won't be applicable to four rather substantial tax provisions that will be expiring for the most part on December 31, 2010. Why did you give this exoneration to the current policy baseline for these particular programs?

Mr. ORSZAG. Again, I think there is—and they are not just tax provisions. It is also applying to the sustainable growth rate formula.

But with regard to the exceptions that we put forward, I think there is widespread agreement that there will be some extension. We are not going to allow physician payments to fall by 20 percent. We are not going to allow the alternative minimum tax to take over the Tax Code. And I don't think anyone is proposing or embracing that none of the 2001 and 2003 tax legislation is extended. Perhaps some Members of Congress are. But in terms of the bulk of Members of Congress and senators, it is very likely that some significant part of the 2001 and 2003 tax legislation will be extended. No one has put forward credible offsets in those categories.

For example, on the sustainable growth rate formula—or let us take the alternative minimum tax. There have been 1-year patches that have generally either not been offset at all or been offset with 10-year offsets. No one has put forward a 10-year fix with 10-year offsets.

In that situation where there are no credible offsets that have been put forward, the most likely outcome if you wrote the legislation based on current law is that the rules would just be waived when those extensions came up. We thought it would be better to write the legislation in a way that didn't immediately trigger waivers, because we think waivers—once you get in the—I guess the theory of the case is once you get in the habit of giving waivers, you could get too used to giving waivers; and it would be better to write the rules in a way that recognized reality and then not have waivers.

Chairman SPRATT. To make it clear, you are not sanctifying these tax cuts at these levels necessarily or calling for their reenactment or reinstatement on December 31st?

Mr. ORSZAG. No, it is not a policy statement at all. It is just that if the Congress decides to extend, for example, part of the tax legislation, how that should be treated under statutory PAYGO.

Chairman SPRATT. And there is a time limit on acting to take advantage of the exclusion here?

Mr. ORSZAG. That is right.

Again, if we step back and realize why we are in this situation, the reason we are in this situation is that—especially with regard to the 2001 and 2003 tax legislation, which is the biggest single component, there was an artificial sunset put into the law at the end of 2010, which creates this awkwardness between the current law and current policy baseline. That not a good way of making policy.

Chairman SPRATT. One more question. The sequestration base. Did you say a word about how the legislation that could be subject to sequestration was chosen and what methods you took to choose it? Are you simply carrying forward what was last in law or have you made some modifications to it?

Mr. ORSZAG. We were generally—we were carrying forward the spirit of what was last in law, which exempted low-income, veterans, retirement programs, and a few others. Unfortunately—well, not unfortunately. There were some new programs created that needed to be put into one bucket or the other, and we tried to follow the same guidelines that had been embodied in the previous legislation. So the vast majority of the exemptions to sequestration are exactly the same as under the 1990 law. We just had to update it for programs that were created since then.

Chairman SPRATT. One final question. What you are proposing is statutory PAYGO. The House has a PAYGO rule, which is the rule of the House. The Senate has a PAYGO rule. Is it your anticipation that the House and Senate rules will stay in effect as well?

Mr. ORSZAG. Yes. That is, I guess, the belt part of the belt-and-suspenders approach to PAYGO.

Chairman SPRATT. I won't ask which ones are the suspenders and which ones are——

Mr. ORSZAG. Yeah. Well, I will let you choose.

Chairman SPRATT. Mr. Ryan.

Mr. RYAN. Thanks, Chairman.

Peter, in the past, PAYGO was accompanied with discretionary spending caps; and I think a lot of observers of your budget would say that your discretionary spending path is unrealistic. I would like to see it materialize as you lay it out after the first year. The first year you go up 11 percent, and then you average less than 3 percent over the rest of the 10-year window. Would you be willing—would the administration be willing to lock in those numbers with statutory caps?

Mr. ORSZAG. We would be willing—let me first say—I am just going to correct a few things. The discretionary spending increase is artificially affected by things like the Bureau of the Census.

Mr. RYAN. I will concede the first year is 11 percent, but it averages less than 3 percent over the next 10 years.

Mr. ORSZAG. Focusing on the outyears, I think the most important single thing we could do is enact statutory PAYGO for mandatory and revenue. Remember, over the past 8 years, we doubled the size of the long-term fiscal gap in this Nation by enacting tax legislation that was not offset and a prescription drug benefit that was not offset and present value that is 3 percent of GDP; and that doubled the size of the fiscal gap.

Now, discretionary spending can matter, also. We have put forward a path we support. If one were to pursue discretionary caps, we would want them to be at the level that we have put forward. That is a discussion we could have. But I think first things first. Let us focus on where most of the money is, which is on the mandatory side and the tax side of the budget.

Mr. RYAN. Forty percent of the money is not peanuts. So since you have a path you subscribe to, you believe in, it is 40 percent of the spending. In the past, it was accompanied with statutory caps on discretionary. Why not support discretionary caps at your levels?

Mr. ORSZAG. It is an idea that we would be willing to pursue with you and discuss with you. But we thought it was most important—especially given the past history of where the most deterioration occurred—focus on where the problem is.

Mr. RYAN. Let us go on to that, then. We are on the verge of creating a brand new entitlement, a brand new entitlement that will provide eligibility numbers that rank up there with the size of Medicare. And, therefore, its liabilities could, could rank up there with the size of Medicare.

I want to applaud you and thank you for standing by CBO and rejecting some of the entreaties to have OMB scoring for the health care bill and to stick with CBO. By the way, I am glad the administration is sticking with assuring that we have CBO scoring on the health care legislation and that—I assume you are sticking with the 10-year pay-for. You are going to pay for it within the 10-year window, correct?

Mr. ORSZAG. Health reform must be paid for over 10 years and in the tenth year.

Mr. RYAN. Right. That is great.

What about the years after that? What about the long-term fiscal gap? What about the long-term effects of this? Will the administration give us long-term scoring as to what kind of debt we are going to be passing on to the next generation in addition as a result of this program? Will the administration be able to show us that the revenues, the pay-fors will actually match the expenditures in the outyears? Or, in fact, are we creating yet another liability for the next generation on top of the $62 trillion we have right now, according to the GAO?

Mr. ORSZAG. Three comments. First, contrast how different this is from the process that was used for the prescription drug benefit where there was no offset at all. We expanded the long-term fiscal gap by a percent of GDP by doing so with no offsets.

Second, the reason that we have said that we want deficit neutrality in the tenth year is that is the best proxy for what will happen in the second decade. By that time, the program should be fully phased in. And if you have deficit neutrality in your 8th, 9th

and 10th year, for example, you are not falling off a cliff towards the back end of the decade——

Mr. RYAN. Great point. So does your deficit.

Mr. ORSZAG. And there is a third point. And then the third is, remember, that is not counting any of the transformation that we believe is crucial. And what I would say on that is there may be some debate over exactly how much you will get out in 2050 from these ideas. But everyone must agree they are necessary. Some people may not believe they are sufficient, but they are necessary for transforming the health care system.

Under your consumer-driven health approach, for example, you need health IT and more research into what works and what doesn't so that consumers have better, more informed choices. We are doing hard things there precisely because we firmly believe that if we don't, nothing else is going to matter.

Mr. RYAN. Does your deficit neutrality apply to the outyears? Does it apply to the long term?

Mr. ORSZAG. As you know, CBO only does 10-year——

Mr. RYAN. I know.

Let me go to an episode we had in Ways and Means where the Republicans made a mistake. You know who Rick Foster is? He is the chief actuary at CMS. I have some House Ways and Means colleagues that are here with me. Lloyd was here then.

When the prescription drug bill was done, the CMS actuary put out some long-term estimates. Those estimates were not provided to Congress, and that was a mistake. We used CBO—I see Doug Holtz-Eakin shaking his head there. That was a mistake. And the minority at the time was right to point out that the administration should not have sat on those estimates that would have better informed Congress as to the fiscal decisions they were making.

It turned out those estimates were way off. It turned out CBO was way off. It turned out this benefit came in 40 percent below projections.

But my question is, will you allow the CMS actuary to give us these kinds of scores and make them available to Congress? Because that was a mistake the last administration made. I hope you don't repeat that mistake. And will you allow the CMS actuary to do the long-term scoring, 10-year and long-term scoring on this new entitlement benefit so we can get a better picture of what we might be passing in 3 or 4 weeks here?

Mr. ORSZAG. Three comments. First, I am firmly in favor of disclosure of information to the Congress.

Second, the CMS actuaries, as you know, are responsible for Medicare and Medicaid. Their ability to model systemwide health changes like we are talking about——

Mr. RYAN. Probably better than anybody else's ability.

Mr. ORSZAG. Although that is not what they are paid to do. I just want to note that. So there is an awkwardness. The prescription drug benefit was within their four corners. This is not.

And then, finally, as you pointed out, I think sometimes there is a thought that, even if you are deficit neutral, somehow the projections are always biased too low and therefore we are going to wind up in a bad situation. And, as you noted, the prescription drug numbers have actually come in lower than projected, making the

point that, in general—CBO, for example, does its best job. Sometimes they are too high. Sometimes they are too low. They are not biased in one direction.

Mr. RYAN. I would argue it is sort of the nature of the program that brought those numbers where they are.

But let me ask you this. Don't you think we ought to have a handle on what we are creating over the long-term with this new entitlement, this new health care entitlement? You of all people have been so articulate in coming to Congress, especially in your old job, of saying what a fiasco we have got financially, the indebtedness of this Nation, the long-term unfunded liabilities. Shouldn't we get a handle on what kind of long-term unfunded liability we might be creating before we vote to create this new entitlement program?

Mr. ORSZAG. And I would again say by far the best protection you have against that—a belt-and-suspenders approach there, too, where you not only have deficit neutrality over the first decade but in the 10th year alone, using hard scoreable offsets. And then we have an aggressive set of game changers which are not even included in those calculations but that are the most auspicious approach to bending the curve over the long term.

And just remember, health care is so dominant and the costs are growing so quickly that even small reductions in the growth rate dominate everything else. Reducing the growth rate of health care costs by 15 basis points, point 15 percentage points per year has a larger impact on the Nation's long-term fiscal gap than eliminating the actuarial deficit and Social Security deficit.

Mr. RYAN. So why can't we get those numbers? Don't you think we ought to have that before we——

Mr. ORSZAG. Sure. But the only thing—you are looking to the CMS actuaries, and what I am saying is that is not their job.

And the second thing is it is very difficult to quantify many of these game changers precisely because we have never moved to a high-performing, higher-quality, lower-cost system.

Mr. RYAN. I guess what we are getting is we are going to vote on a new entitlement program without knowing its long-term fiscal effects.

Mr. ORSZAG. No. Again—look, the 10th year constraint is very similar to the constraint that is often imposed on Social Security at the end of the 75-year window. If you are not falling off a cliff at the end of your projection window, that is your best assurance that the long-term trajectory is also stable.

Mr. RYAN. Thank you.

Chairman SPRATT. Thank you, Mr. Ryan.

Mr. Doggett.

Mr. DOGGETT. Thank you, Mr. Chairman.

Dr. Orszag, I actually share a number of the concerns that Mr. Ryan has just raised, if not necessarily all of the conclusions. I was one of the many sponsors along with our—under leadership of our colleague, Congressman Hill, last session. His measure for statutory PAYGO included the discretionary spending caps that Mr. Ryan was just asking you about. It did not include all of the exceptions that you have.

I voted against some measures on the House floor that I support, such as correcting the alternative minimum tax because they were

not paid for. And it seems to me that, to the extent that you have all these exceptions, that we are basically prejudicing our policy in favor of continuing Bush tax cuts, doing some of the other things that you have here and against other necessary measures.

Let me ask you, though, in order for this process to work, you have to have honest scores. Who will be the scorekeeper for statutory PAYGO under your proposal?

Mr. ORSZAG. Because of constitutional constraints, the scorecard has to be maintained by the Office of Management and Budget. So another difference between the congressional rule and statutory PAYGO, one is sequestration, but the other is—your rule is based on CBO scoring; statutory PAYGO must be based on OMB scoring.

Mr. DOGGETT. Citing the example Mr. Ryan just used, which was an infamous example, not put in place I think to deceive Democrats but to deceive Republicans on the true cost of the prescription drug program as it was originally estimated, how do you think score keeping would have worked the last 8 years in the Office of Management and Budget?

Mr. ORSZAG. Well, again, I think perhaps sometimes the implication is that the administration biases scores down. There is an example where it was actually higher than CBO. I will very firmly defend the staff at OMB who are highly professional and outstanding analysts. I don't believe that there is a bias either in CBO scoring or in OMB scoring in terms of new programs one way or the other.

There are technical differences. Creating a new prescription drug benefit had—was—you were creating a whole new program, and analysts can reasonably differ—the CMS actuaries versus the Congressional Budget Office can reasonably differ on such things. But if an undercurrent here is that somehow the administration is always biased in one way or the other, I am going to defend my staff here and say I don't agree.

Mr. DOGGETT. Well, I think it is the decisions that were made with those numbers that were a problem under the last administration.

Mr. ORSZAG. Oh, I agree with that. Withholding information is a problem. That is a different question.

Mr. DOGGETT. What is the nature of the constitutional problem that would prevent anyone other than OMB being the scorekeeper?

Mr. ORSZAG. The issue really is that sequestration happens automatically. And to have that happen automatically based on a legislative body's judgment is the constitutional issue that has arisen.

Mr. DOGGETT. Isn't there a way to write this legislation to give the Congressional Budget Office a bigger role in score keeping?

Mr. ORSZAG. I don't believe so. But if you would like to have follow-up discussions with the staff, I would be happy to entertain that. I believe that we have—I think it is very difficult to do anything other than the way we have designed it.

Mr. DOGGETT. While our perspective is not entirely the same, I do agree that for those of us who are concerned about education deficits, about health care deficits, about law enforcement deficits, we won't be able to address those deficits if interest payments are such a substantial share of our national budget; and it is essential

that we work together, as you are trying to do today, to address the need for more responsible pay-as-you-go government.

Thank you very much.

Chairman SPRATT. Thank you, Mr. Doggett.

Mr. Hensarling.

Mr. HENSARLING. Thank you, Mr. Chairman.

Welcome, Dr. Orszag. I found your comments on PAYGO to be helpful and instructive, although there is still much of what you say with which I disagree.

As I listened to the PAYGO debate—although I find your own voice helpful, I find other voices somewhat unhelpful. And as I listen to the debate, I am struck between the difference between what I might view as a bumper sticker slogan and a real program for spending discipline. So I think it is important that the American people have the facts.

So I want to make sure that we are clear on this point. Number one, under the administration's PAYGO spending plan, increases in discretionary spending are exempt, correct?

Mr. ORSZAG. PAYGO applies to the mandatory part of the budget and to revenue; and, therefore, discretionary spending could be handled either through the normal congressional process, the 302(a) and (b) process, or——

Mr. HENSARLING. So is the answer yes?

Mr. ORSZAG. The answer to that would be PAYGO does not apply to the discretionary——

Mr. HENSARLING. Thank you. Thank you.

So if Congress as is in the current budget planning on increasing discretionary spending—nondefense discretionary spending 9.3 percent, they can do that without decreasing spending elsewhere or raising taxes to pay for it, correct?

Mr. ORSZAG. Under your House PAYGO rule and under this statutory PAYGO rule, that is correct.

Mr. HENSARLING. And isn't it also true that, under PAYGO, spending increases in current entitlement programs, they are not subject to PAYGO either; isn't that correct?

Mr. ORSZAG. Spending increases that happen naturally because of demographics——

Mr. HENSARLING. Your current entitlement programs.

Mr. ORSZAG. They are built into the baseline. That is correct.

Mr. HENSARLING. I believe in the CBO baseline, Social Security is due to grow 4.78 percent. Medicare is due to grow 4.3 percent. Those are spending increases.

Mr. ORSZAG. PAYGO is intended to make sure we don't dig the hole deeper.

Mr. HENSARLING. But those are spending increases whereby Congresses doesn't have to decrease spending elsewhere or raise taxes to pay for it. Is that not correct?

Mr. ORSZAG. That is correct. Again, statutory PAYGO is intended to make sure that we are not adopting new programs to make things work.

Mr. HENSARLING. I understand. I understand. My time is limited, Dr. Orszag. So if one asserts that under PAYGO Congress can only spend a dollar if it saves a dollar elsewhere, that is not literally true, is it?

Mr. ORSZAG. Well, it is true outside of discretionary again, because it depends on what you mean by spend.

Mr. HENSARLING. So out of discretionary, 40 percent of the budget, and outside of current entitlement programs, which as of today, by definition, represents the rest of the budget.

Mr. ORSZAG. I would say spend a new dollar on automatic programs——

Mr. HENSARLING. If one says Congress can only spend a dollar if it saves a dollar elsewhere, is that literally true?

Mr. ORSZAG. That may be shorthand for what I just said.

Mr. HENSARLING. It may be shorthand.

Mr. ORSZAG. Yeah. I don't know who——

Mr. HENSARLING. Might you concede it is misleading?

Mr. ORSZAG. It would be a form of shorthand.

Mr. HENSARLING. It would be a form of shorthand. So when the President spoke those very words on June 9th, you would say he was speaking to the American people in shorthand?

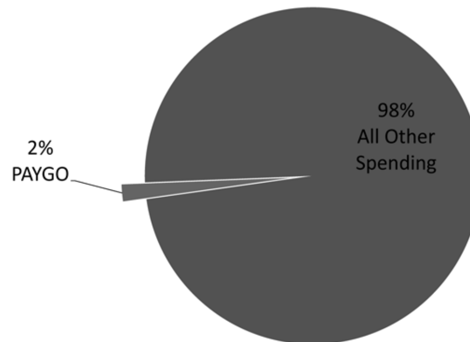
Mr. ORSZAG. Undoubtedly. He was giving a speech, and in a speech there aren't as many footnotes about sequestration.

Mr. HENSARLING. Well, that is part of the problem here. I sense the administration is trying to get credit for something that, frankly, doesn't quite live up to its billing. My fear is, if the administration was a private firm selling a product called PAYGO and made those claims about it, they would be sued by the FTC for false advertising.

Can we pull up charts—chart number 3, please?

3

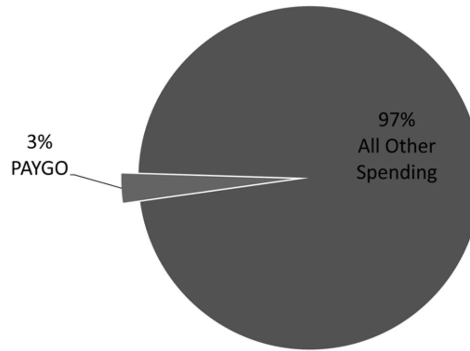
Spending Increases Subject to PAYGO in 2009



$870 Billion in Spending Increases in 2009

Again, my concern is is that people are trying to get credit for something that doesn't actually occur. Chart 3 shows the spending increases that were subject to PAYGO in 2009. Yet $870 billion in spending increases in 2009, 2 percent, 2 percent subject to PAYGO.

Can I get chart number 4, please?



2010 spending, we have got $3.5 trillion of spending estimated for 2010, of which 3 percent is subject to PAYGO.

I guess I would ask this question, Dr. Orszag—and I also see that there is an op-ed in the Wall Street Journal by the Democrat majority leader and Chairman Miller, "Congress must pay for what it spends." Well, clearly Congress is not paying for what it spends.

So, on the one hand, we either have false advertising; or if PAYGO actually does live up to its billing, that Congress must pay for what it spends, given that under CBO projections by 2019 we are looking at a deficit of $1.2 trillion, first income tax revenues of $2 trillion, we would have to increase taxes—income taxes 60 percent to make good on the PAYGO promise.

So which is it? Are we looking at a proposal to increase personal income taxes 60 percent over the next 10 years or simply is PAYGO false advertising?

Mr. ORSZAG. Neither. And remember——

Mr. HENSARLING. I thought that might be your answer.

Mr. ORSZAG. Well, look, if we had this system in place over the past 8 years, roughly 3 percent of GDP was adopted by the Congress and not offset. That is exactly what this PAYGO law is intended to address. So that is almost as large as the entire non-defense discretionary budget is today.

To Mr. Ryan's point, 3 percent of GDP from the prescription drug benefit and from tax cuts that were not offset, that is this year alone almost $450 billion. That would be a very big chunk of your pie chart, adopted without being offset. That is what this law is intended to address. It is not a panacea.

Chairman SPRATT. Mr. Becerra.

Mr. BECERRA. Thank you, Mr. Chairman.

Dr. Orszag, nice to see you again.

Mr. ORSZAG. Nice to see you.

Mr. BECERRA. Let me ask a few questions about some of the provisions that incorporate within the baseline some of the programs that exist that are expected to expire like these tax cuts. Give me

a sense of the 10-year cost of some of those provisions that will not be counted on the PAYGO ledger, AMT indexing. What is the number on that?

Mr. ORSZAG. There is an interaction effect with the 2001, 2003 legislation, but it is about $500 billion or so.

Mr. BECERRA. And the estate tax?

Mr. ORSZAG. The estate tax, I have to get the exact number, but it will be a few hundred billion, several hundred billion.

Mr. BECERRA. Okay. And then the some of the other tax cuts include the two top rates, capital gains dividends. There is a whole category of them.

Mr. ORSZAG. Yeah. All in the exemptions are north of $3 trillion.

Mr. BECERRA. So north of $3 trillion. That would include things like the child tax credit as well, the reduction in the lower-middle income tax brackets as well?

Mr. ORSZAG. That is correct.

Mr. BECERRA. So there is about north to $3 trillion over the next 10 years that would not be counted towards the PAYGO ledger. And you explained part of the reasons for doing that, which there is a lot of logic to it, because we in essence, de facto, or ad hoc'ly are doing that already.

But I am wondering if you can tell me how you—OMB projects our budgets in the future, if we continue to have these deficits hovering above $500 billion, which would be a tremendous accomplishment to get them below the deficit that we saw the President inherit this year from the previous administration of $1.3 trillion or so——

So let us say you are able to achieve President Obama's goal to reduce the deficits in half in his first 4 years in office. We will not be counting in that calculation many of these provisions which are costing the government resources, because you can't do certain things if you don't have the revenues. But we have decided because of the way Congress and the administration have operated over the last several years that you are, in essence, institutionalizing what de facto happens every year ad hoc'ly when we extend these things, patch them through, et cetera. Is that more or less what you are saying?

Mr. ORSZAG. But with a very limited time window and the hope that we will stop this process of patching. Because that is, again, something I said before. It is not good policy to have such large sunsets in the Tax Code or in Medicare policy.

Mr. BECERRA. And I think there is at least a degree of honesty in what you are proposing. At least you are saying we admit that it would be tough to tell American families we are not going to extend a tax credit that we have provided for children. So I recognize that.

Now, let me ask this. If Congress were in the future to decide to allow some of these tax provisions to expire, how would those be treated? How would the revenue that would now come in be treated if we were to not extend some of these tax cuts.

Mr. ORSZAG. That would go for deficit reduction.

Mr. BECERRA. So all of it would go for deficit reduction?

Mr. ORSZAG. If you were not to extend the tax provisions, yes.

Mr. BECERRA. So there is a good chance if you don't extend some of the Bush tax cuts that you might actually be able to see an increased reduction in the deficits over the next several years?

Mr. ORSZAG. Yeah. And let me just comment on that. The deficit this year is elevated $1.8 trillion. $1.3 trillion of that is due to the economic downturn and steps necessary to address it. That $1.3 trillion will gradually disappear as the economy recovers and the extraordinary steps necessary to stabilize the economy are no longer necessary.

Beyond that, to address that underlying structural deficit, there are various things that could be done. As you go out further over time, we are back into exactly what we were discussing before, which is the key driver of our long-term deficits is health care. That is exactly why we are putting such emphasis on getting health reform done now in a way that is fiscally responsible and also puts in place a structure so that we could bend the curve over the long term.

Cost containment in health care is going to be a continual effort that we have to keep—it is not—you know that Staples thing? It is not like you pass the bill and go "that was easy." You have to keep at it over time, and we are putting in place a structure that will allow that to happen more naturally. That is perhaps the most important single thing we can do to put the Nation on a sounder fiscal course.

Mr. BECERRA. Mr. Chairman, I appreciate it. Thank you very much.

Chairman SPRATT. Thank you, Mr. Becerra.

Mr. Garrett.

Mr. GARRETT. Thank you, Mr. Chairman.

Dr. Orszag, as Jeb just mentioned to me before he left, so what you are saying is the appropriate rallying cry for the administration and the Democratic majority should be stop us before we spend again?

Mr. ORSZAG. Was that a question?

Mr. GARRETT. Well, I don't know. I appreciate your commentary. I appreciate the administration's new-found interest in spending restraint. I wish it had come a little bit earlier in their administration.

Some of us sitting on this side of the aisle had been willing to vote against our majority, when our President, when we were in power, were asking us to spend more than we thought was fiscally prudent, more than you thought so when you came before the committee and testified was fiscally prudent; and we were willing to stand up to our party.

I guess maybe you are like I am, sitting on the edge of your seat waiting for someone from the other side of the aisle to exemplify that same restraint that some of us, maybe a minority on our own side, exemplified during that time. So far we haven't seen it in the 3 years that they have been in the majority.

I am discouraged that, as Jeb was pointing out, that this proposal applies, as he indicated, to increases or reductions in tax rates and any new expanded entitlement programs. It does nothing to affect the wave of entitlement spending as Paul was talking about before that we are going to see come in. It does nothing to

address the waste, fraud, and abuse of taxpayer dollars that we have been seeing through discretionary spending. So enacting PAYGO at this point is a little bit like closing the barn door after the horse has gone out.

The chairman mentioned that they implemented PAYGO on the first day of the 110th Congress, but haven't they waived it a whole bunch of times—can you just answer that yes or no—since they came in?

Mr. ORSZAG. I am not aware of PAYGO being waived.

Mr. GARRETT. No? How about his——

Mr. ORSZAG. Let me——

Mr. GARRETT. Let me just tell you this. In the first 2 years after reinstalling it——

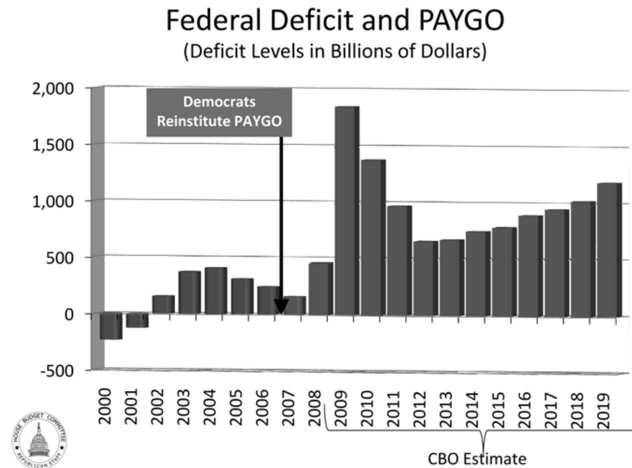
Mr. ORSZAG. Sorry. I thought you said this year.

Mr. GARRETT. He said the 110th Congress.

Mr. ORSZAG. Oh, yeah. No, there have been waivers. And, in fact, again one of the reasons that we were focused on providing these exclusions was precisely to minimize the waiver——

Mr. GARRETT. Let me just remind you what that did. They waived it for $420 billion of legislation in the first 2 years, including $23 billion for the farm bill. They had a scheme set up with regard to SCHIP so that—what he signed in law in February. The bill increases SCHIP spending by an annual of 23 percent for 5 years and then cuts SCHIP funding by 65 percent in its sixth year based on their plan. And the bill is basically deficit neutral over 10 years in order to meet the schedule. So they were able to waive it despite the chairman proudly saying that they were doing something great during that time.

Senator Coburn back on June 16th released a report that contains some truly interesting information. Despite the claims that the Obama administration said that they wouldn't include funding in the stimulus package for the so-called program called FutureGen project in Illinois, the Department of Energy announced that FutureGen would be receiving $1 billion of stimulus money. So see Chart 1.



Now, let us review. This is a project that just last year the Secretary said was a waste of money. He said that since 2003 when the project was announced, the project's estimated cost had almost doubled, and innovations in technology and changes in the marketplace had created other viable solutions, and it became clear the Department of Energy could not in good conscience continue to support the program, and none of the benefits, et cetera, was worthwhile.

So, Dr. Orszag, are there any provisions in the statutory PAYGO that you are talking about that would do anything to curtail this particular program or future programs, such as this that come out of the administration?

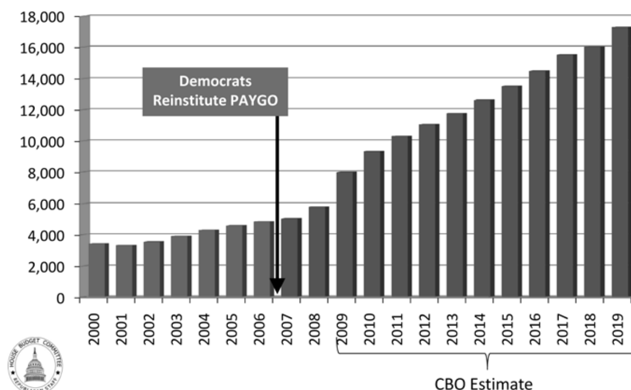
Mr. ORSZAG. Again, as was discussed before, the discretionary part of the——

Mr. GARRETT. So the answer is—I don't have much time. So the answer is no.

Mr. ORSZAG. The discretionary part of the budget is dealt with under separate rules.

Mr. GARRETT. Right. The answer is no. We will continue to see things out of the administration like this.

How about chart number 2? Look at chart number 2. Also contained in the stimulus package was what was deemed so critical that we voted on it without having any time to read the bill, and that is the stimulus plan. There was $800,000 for repaving a backup runway at the John Murtha Airport. To review, this is an airport that, according to ABC News, has only three commercial flights and about 20 passengers per day. So is there anything in the proposal that would either, A, eliminate this particular program that seems to be a waste of money or, B, stop this type of program in the future?



Mr. ORSZAG. I suppose we can go through the entire discretionary——

Mr. GARRETT. I only have two charts.

Mr. ORSZAG. Okay. Same answer.

Mr. GARRETT. Okay. So at the end of the day, we come down to it, that the program in place that had been touted on by the other side since they came into power has not been implemented fully as they suggested, has been waived repeatedly as we have seen from upwards—in the farm bill for $420 billion and other bills and the like; and going forward we will see that it will just be a de minimus amount of the portion of the budget.

Mr. ORSZAG. I am going to again remind us, though, we doubled the size of the Nation's long-term fiscal gap over the past 8 years——

Mr. GARRETT. Let me cite those numbers. You keep on saying those numbers are around $450 billion under the Bush administration, right, that you are citing as an example of that?

Mr. ORSZAG. Just new, unpaid-for measures in one year alone, yes.

Mr. GARRETT. But in the stimulus program, which was $787 billion, none of that was offset, was it?

Mr. ORSZAG. Nor should it be, given that the intention was to bolster aggregate demand. There is——

Mr. GARRETT. PAYGO would have an exemption if the intention is good?

Mr. ORSZAG. No, no, no. Look, there is a much different situation when the economy is weak, facing negative—remember what the situation was towards the end of last year?

Mr. GARRETT. Are there exemptions in the law for that then?

Mr. ORSZAG. Growth was falling. Again—well, two things. One is, there are emergency exemptions built into statutory PAYGO, as there should be, because we do not need Herbert Hoover economics during a great—during a downturn. Cutting back—one of the things that is I think crucial to remember—and I, again, am very

concerned about fiscal discipline. But during a situation where GDP is falling 6 percent on an annualized basis, a temporary increase in the deficit, by all mainstream economic thought, is beneficial; and preventing that would actually be quite detrimental.

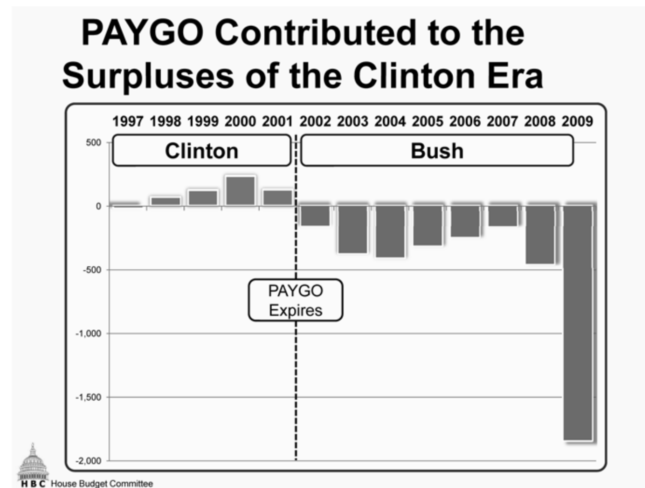
The problem is, as you go out over time and the economy recovers, you don't want structural deficits at that point. And this legislation, admittedly not a panacea, is just intended to make sure you are not making those structural deficits in outyears bigger.

Mr. GARRETT. Thank you.

Chairman SPRATT. Mr. Scott.

Mr. SCOTT. Thank you, Mr. Chairman.

Can we get the chart?



Dr. Orszag, you are familiar with this chart that shows that when the Clinton administration came in, we had inherited a great deficit and created a surplus, enough so that if we hadn't messed up the budget over the last 8 years we could have paid off the national debt held by the public by last year. You don't create a chart like that by accident. There are reckless fiscal policies in the red and fiscal responsibility in the blue.

My question to you is, how does it feel to get lectured on economic policy and fiscal policy by the authors of the red policy?

Mr. ORSZAG. I am not sure that was a question either. So I will just let it stand there.

Mr. SCOTT. In the setoffs—we have a 10-year setoff. It seems to me that that is one of the problems we got into in creating the red. We would score things with setoffs much later on that never would take place. Would a 5-year window make more sense than things like the Medicaid setoffs put way down and when you got there you knew you wouldn't do it? Would a 5-year window be more responsible?

Mr. ORSZAG. There are tradeoffs. But I would say, actually, a big problem was the most expensive things enacted during that most recent red period were not even offset at all. So it wasn't a question

about whether the offsets were back-loaded or front-loaded or whatever. They were nonexistent.

Mr. SCOTT. Part of the fraud on the numbers was this phase-in fraud, and I think you were discussing that a little bit with the ranking member, where you have a delayed implementation and a kind of phase-in so that the 10-year cost was—for a billion dollar a year program could only be $2 or $3 billion in the first 10 years. For the next 10 years, fully phased in, you have to pay it all. What does the PAYGO—statutory PAYGO do about that phase-in fraud?

Mr. ORSZAG. Well, what it would do actually is, if you had a hockey stick kind of profile, you would have to pay some of that up front. And that would actually—so if you can imagine, you know, a cost out in year 9 would actually create a PAYGO violation to the extent it wasn't fully offset in year one, this year, and it would trigger sequestration this year. So there are tradeoffs. There is no perfect set of rules.

But one desirable attribute of this approach is that if you try to adopt a hockey stick kind of thing, you could get—immediately facing a threat of sequestration and that may help to prevent hockey sticks.

Mr. SCOTT. So you would have to pay—you would have to consider the fully phased-in cost, not just the 10-year average cost?

Mr. ORSZAG. Well, the 10-year average cost would reflect in part the fully phased-in cost.

Mr. SCOTT. Yeah. But you could have—a 10-year, billion-dollar-a-year program phased in could cost $3 billion the first 10 years and $10 billion the last 10 years.

Mr. ORSZAG. Right. And one of the problems—I think there are a lot of improvements in the version that we have to try to prevent gaming, but no set of rules is going to be perfect. And there are always going to be very clever Members of Congress and Senators and members of staff that can work their way around any set of rules. We think in a variety of ways we have come up with a better approach than the 1990 legislation to prevent gaming. But one has to be constantly vigilant, because any set of rules always has some flexibility to it and could be abused.

Mr. SCOTT. Now, your baseline includes current policy. Does that include as policy the 2001, 2003 tax cuts that primarily apply to the income over $250,000?

Mr. ORSZAG. It includes both those below $250,000 and above $250,000. I understand there is some debate about whether—from a policy perspective, we do not support extending the tax cuts above $250,000. So the fact that—their treatment in the baseline for this purpose would be irrelevant, because we don't support their extension.

If you are going to count those tax cuts as part of the business line, shouldn't we be able to choose not to extend those and instead pay for health care? People may decide that they want to have health care than an AMT or health care than an estate tax repeal or estate tax rather than other taxes. And the whole point of this is making the right choices. Would we have the opportunity to make those choices under statutory PAYGO as introduced.

Mr. ORSZAG. No, you would not have the opportunity to use the non-extension of the upper-income tax provisions as an offset for

health care reform. That non-extension would go for deficit reduction.

Mr. SCOTT. Shouldn't we have that choice?

Mr. ORSZAG. The administration's position is the non-expansion of those provisions should go for deficit reduction.

Chairman SPRATT. Thank you, Mr. Scott.

Mrs. Lummis.

Mrs. LUMMIS. Thank you, Mr. Chairman.

I am always amazed, as a freshman Member of Congress, when I hear the excuse for Federal spending going forward at alarming rates that it was at alarming rates before now. Because, as a freshman, I would argue that Congress overspent before I got here and Congress is overspending now.

Could we put up a chart, number one, please?

This chart illustrates what was happening before I arrived. It also illustrates that Democrats reinstituted PAYGO; and at the reinstitution of PAYGO, the deficits just got larger, and larger, and larger going forward. The red bars are increasing deficit levels in billions of dollars.

So, as a freshman, as I said, I am just stunned by the logic in this town where people say, because the Republicans overspent while they were in charge, we, the Democrats, get to overspend to two and three times the level that the Republicans overspent when they were in charge.

I am dismayed, I am frustrated, I am disappointed with this year's spending spree. How does the administration intend to enforce fiscal discipline on the discretionary side, particularly after fiscal year 2010?

Mr. ORSZAG. Again, we have put forward—even just focusing on fiscal year 2010—a set of proposals; and thereafter, as you know, a glide path that will get non-defense discretionary spending to the lowest levels since 1962. We put forward a set of specific reductions also as part of the fiscal year 2010 budget to terminate programs.

I appreciated that your caucus or members of your caucus put forward your own ideas on specific spending reductions that could be adopted. I would note that, in terms of specific spending reductions, individual programs that you all put forward, you were able to come up with $3 billion a year. That is a good start, and we are looking at the suggestions, but there is also just a recognition that this is hard work, and we would want to work with you to do better than that.

Mrs. LUMMIS. I would like to return my attention for the next question to what is admittedly a small part of that, but it is one that irks the American people, and that is earmarks.

Earlier this year, the President signed a $410 billion appropriations bill with nearly 9,000 earmarks; and the reason, apparently, that that was signed was because that was last year's business. But just last week, the House considered the Commerce, Justice, and Science appropriations bill with roughly 1,100 earmarks in that bill alone. So my question is, would this legislation, as it passed the House, be signed into law by the President?

Now, this is a President, when he was campaigning, said that he wanted to change earmark policy, that he opposed earmarks, and that this was an important hallmark of his campaign. Thus far, I

haven't seen a demonstration of the principle he articulated during his campaign.

Mr. ORSZAG. Three things. First, with regard to earmarks that go to for-profit entities, we are glad that the Congress has agreed we are going to make sure that those are competed. So that will be beneficial.

Second, the administration is now, before a conference report, actually asking the relevant agencies to scrub the language and look for earmarks that can be identified much earlier in the process than had been the case before.

Third, we have already identified, for example—the example that comes to mind is the pre-disaster accounts at FEMA. We have expressed concern in one of our statements of administration policy about earmarks in those accounts.

So you will be seeing us expressing concerns where we can quickly identify inappropriate earmarks, and I would look forward to working with you to reduce them as much as possible.

Mrs. LUMMIS. And will the President veto bills that have earmarks that don't meet your standards?

Mr. ORSZAG. The President will veto bills that don't meet his standards. Now exactly what they are, we need to work with you, and that was what I was just describing, a process for trying to get earmarks down as much as possible and also identify them as quickly as possible so that we all know what we are talking about.

Mrs. LUMMIS. Thank you, Mr. Chairman.

I have just one more comment. I do not see how we can add trillions in deficits in debt over 5 years and still be PAYGO compliant.

But my time is up, and I yield back.

Chairman SPRATT. Ms. Schwartz.

Ms. SCHWARTZ. Thank you, Mr. Chairman, and thank you for this hearing. And, Dr. Orszag, good to be with you.

I am one of the original cosponsors of the original PAYGO legislation, and while we certainly can go back over history—both positive and negative—the fact is that, going forward, this administration has proposed or is taking very seriously our rules on PAYGO and suggested making it statutory. I am going to embrace that. I believe that we should.

And I appreciate the fact that you have been very straightforward with us about how hard this is going to be to do. To be fiscally disciplined is not easy. There are a lot of things that call on us to do it, but we are making a determined commitment to do so. And your building on the experience of 1992 is extremely helpful.

When people say, can you do it—the previous speaker just asked, can you change what we do? And the fact is that, in 1992, the Federal deficit was—it was a lot then. It was $290 billion. And, by 1998, the government had a surplus of $69 billion. So we did reverse a trend towards increasing annual deficits and a national debt with PAYGO, with spending discipline, and with tax discipline as well.

So I appreciate your pointing out the fact that the change in history from 2002-2011 was really due to the previous administration's very clear policies on tax decreases and increased spending.

And that was not sustainable, and we are trying to reverse that by being more responsible on both spending and tax policy.

What I want to ask you about—and I recognize that this is not easy—I think that we have made it very clear that we work with CBO, we listen to CBO. How CBO scores what we do is extremely important. I think it is appropriate for CBO to be pretty conservative about scoring savings. I think that is very important and would want them to do that.

I think, you know, in health care—and you pointed this out in your testimony—that we have made a commitment in health care reform working with the administration to make this revenue neutral in 10 years, over 10 years, at 10th year—however you say it. And that is a very strong commitment to pay for through savings and through increased revenues if you need to. What we are looking at now in Ways and Means is at least half coming from savings, which is very significant, and, of course, the tough decisions about how we raise revenues.

There is a frustration—I will put it that way—in some of the aspects that you have talked about, in improving the delivery system, in the incentives we are going to put in for primary care, and helping to do chronic disease management better, comparative effectiveness so that we can do research and disseminate that to physicians in a more timely fashion so that they are providing best practices for their patients, some of the accountable care organizations, the kinds of ways that we are very determined to make investments now. Health IT that we have done already but want to continue to. That we can make investments and changes in the delivery system that will save money. Most of those investments are not scored to savings.

Now, in other economic think tanks, in other sort of—I was going to say public initiatives. In Pennsylvania, we have something called the Health Care Cost Containment Council, and they are charged with giving the State legislature actual analysis of what investments would save money. I have to ask for it. They come back. We sometimes disagree with what they say, but it does give us the ability to say we are going to actually cover new mandates that is arguable whether it is useful to do. Cancer screenings, does it save us money? Should we do it?

Do you think that there is anything more that we should encourage CBO to do, that CBO could be doing or someone else could be doing to help us in Congress be able to know that these investments actually do end up in savings, whether scored or not and preferably scored?

Mr. ORSZAG. Well, actually, Senator Conrad and Senator Gregg asked exactly that question of CBO last week; and the letter that came back from CBO said exactly what I said, which is cost containment over the long term is difficult, and it will be an ongoing process. But in a section on options that could reduce long-term cost growth, they pointed to many of the same things that you just described: accountable care organizations, bundled payments, a process for updating Medicare policy and health care policy in a continual way, and so on and so forth, most of which is fully under discussion as part of health care reform. There wasn't a single item on their list that isn't under discussion up here on Capitol Hill.

So that is a reflection of what I have been trying to say for a while, which is no one can quantify out in 2040 or 2050 what the impact of these things will be, but the set of policies under discussion reflect the most auspicious set of policies that could help bend the curve under the long term.

Ms. SCHWARTZ. What you are saying is that, in addition to the savings that are quantifiable, we do expect, while difficult to quantify, that there will be additional savings, particularly over the long term. So when the question is where do we go in 10 years, are we actually going to see an increase in costs, we actually may see—the suggestion is and the belief is from the economists and from all those who work in health care is that we are actually going to see more savings than we actually have been able to quantify right now in a way that will help protect Medicare and be able to pay for Medicare going forward and hopefully bring down costs in the private sector as well through cost savings and the delivery system. I think that is correct.

Mr. ORSZAG. Let me even be more direct here, because I think this has been a subject that deserves more attention.

There is no plausible way that we are going to get our long-term fiscal situation under control without structural change to the health system. And people can disagree about whether what we are putting forward is enough or not, but without that, a change in the infrastructure so that we have computerized records, so that we have a system of evaluating of what is working and what is not, without changes in financial incentives so that we are oriented towards quality instead of quantity, and without some way, in a more facile way, updating Medicare policy, there is nothing that anyone can propose that will put us on a sustainable fiscal course.

Now, some people say those set of policies are not enough to put us on a sustainable fiscal course, and that may be right. But to those of you—those who are saying that, I think you have to agree that we have to at least do that. In other words, even if you don't think it is sufficient, I think everyone has to agree those steps are necessary.

Ms. SCHWARTZ. Just to make clear that all of those steps are actually in the health care reform draft legislation that we are debating right now in Congress?

Mr. ORSZAG. Correct.

Chairman SPRATT. Mr. Schrader.

Mr. SCHRADER. Thank you, Mr. Chairman.

I apologize for not being here for some of your remarks.

Why did the Republicans allow PAYGO to lapse?

Mr. ORSZAG. I think you would have to ask them. I am not exactly sure. But presumably there is—well, I will let you ask your colleagues.

Mr. SCHRADER. You have talked pretty eloquently about the opportunity for health care reforms to bend the cost curve long term and get us back into balance hopefully in our long-term national debt situation.

Do you, by offering up the PAYGO legislation and making it statutory, do you think that also has an opportunity, given the propensity for Congress with all of our well-meaning intentions, to help

in the cost of government growth over the long term, also, compared to what we have been doing?

Mr. ORSZAG. It reflects our approach to health care reform. I would not support an approach where all we were doing are these steps that are aimed at transforming the health system and kind of bank on that.

If I could just spend a second—some people have equated what we are trying to do with the steps that we were taking in the early 1980s in proponents of supply side economics. Huge difference. Those tax provisions, there was a theory that the case put for them. They were not offset.

So we are saying, do the key things that we think will change the structure of health care over the long term and that are necessary and perhaps sufficient to bending the curve over the long term but also offset what you are doing up front, and that reflects the PAYGO principle, which is at the heart of this legislation.

Mr. SCHRADER. A couple of technical questions, if I may.

The estimates in section 4, they talk about using the President's proposed budget as the baseline. Why not use whatever is in the budget resolution by Congress instead, since it has more force of law? Because the President's budget is a proposed budget.

Mr. ORSZAG. There are different ways of doing it. I need to just check on exactly what section 4 is. Because if it was speaking to the exclusions as opposed to the way that the ledger works—I mean, one could write the legislation in different ways.

I again, though, want to come back to the constitutional issue that was discussed briefly before. One of the reasons that OMB scorings has to be used and therefore it would make sense to use the President's baseline is a constitutional issue regarding the triggering of sequestration.

Mr. SCHRADER. This was slightly different. I don't need the answer right now.

The other technical question would be, you talk about the scoring procedures and you indicate how usually Congress and the executive branch usually end up with somewhat the same type of scoring estimates and stuff and scoring procedures. Is there any reason you wouldn't want to encourage or, more specifically, get Congress and the President of the executive branch, if you will, to use the same scoring procedures and make that more definitive in the legislation?

Mr. ORSZAG. Again, in just looking at the legislation, section 4, which describes how the PAYGO ledger works, the reason that you are using administration numbers there is a constitutional issue. So my previous answer was, now that I see the section, was exactly correct, which was that we can't use congressional estimates to trigger sequestration and, therefore, we can't use congressional estimates to enter items on the statutory PAYGO ledger.

Mr. SCHRADER. Thank you.

Mr. ORSZAG. If you could fix the constitutional problem.

Mr. SCHRADER. We can't seem to fix much in that regard, which may be a good thing.

Last question. There is reference in here within 14 days the President would—hopefully, it would never go to sequestration. It is a deterrent. I understand that. But assuming that, unfortu-

nately, we may have to go there for whatever reason at some point in our country's history, the President issues the order within 10 to 14 days—I forget exactly which—but what is the hammer to make it actually happen? Is there a time the agencies have to be implementing his order?

Mr. ORSZAG. Most of these would be automatic, so his order would go into effect pretty much immediately. I will have to look. But, in general, the agencies—there is nothing subsequent that would have to occur after the sequestration is triggered.

Mr. SCHRADER. One last, last question. With regard to the four exceptions for the next year—maybe two—with the AMT, estate tax, the SGR, and the low-income tax cuts, I assume that is to make sure we don't raise taxes on hardworking Americans at this point in time but realize that within a couple of years after the economy recovers that those two should be subject to PAYGO going forward.

Mr. ORSZAG. I think what those exclusions are intended to reflect is there have been a series of extensions and waivers and to avoid a series of waivers that would undermine—the theory of the case, again, is once you get in the habit of giving lots of waivers, it is hard to stop. So it is better to have a set of rules that you will actually abide by.

Mr. SCHRADER. Thank you.

Chairman SPRATT. Mr. Diaz-Balart.

Mr. DIAZ-BALART. Thank you, Mr. Chairman.

Good to see you, sir. I know you have been slightly busy, so we appreciate you being here.

Actually, a semi-related question. We are now in the midst of putting together the Transportation Reauthorization bill. And do you—understanding the situation, of course, that you do about the DOT trust fund now, which is basically almost insolvent. We are going to have to put some general funds money into it. Is the administration going to be making recommendations as to how we should fund the DOT trust fund, the shortfall, and also the reauthorization, or is that something that you are——

Mr. ORSZAG. What we have said is we would favor an 18-month extension and additional funds being provided during that period and that those funds would have to be offset.

So, again, it reflects the statutory principle, even though this is a different setting, but we support the notion that any additional funds provided to the transportation trust funds would be offset; and we would work with the Congress to make sure that is the case.

Mr. DIAZ-BALART. Again, Mr. Chairman, if I may, I understand that, and I know you are getting some bipartisan pushback on the 18-month, which I know you expected on that extension, but are you going to make any specific recommendations as to either what is in those offsets should be or not?

Mr. ORSZAG. I think we are working with Mr. LaHood and others are working with the relevant committees to decide the best way forward on identifying offset. But what we have said is it must be offset. So regardless of whether we put forward the offsets or we jointly work with you on the offsets or however the process works, at the end of the day, it has to be offset.

Mr. DIAZ-BALART. I appreciate that.

Last thing. This may not be a fair question, but I have you here. Any comment on the Vice President's statement about the fact that—and I am going to paraphrase him roughly—but basically that everybody guessed wrong on the impact of the stimulus?

We do know that, and we had other people testify here recently, and, obviously, the numbers that the administration believed, as far as unemployment numbers, et cetera, that there was going to be a cap of about 8 percent if the stimulus were to pass, we now see that it has greatly exceeded—it has actually greatly exceeded the unemployment according to, again, the administration, that would have taken place if we did nothing. Again—and the Vice President obviously had a comment on that which has gotten a lot of press coverage. Anything you want to—this is an opportunity—kind of a softball opportunity for you to hit out of the park about what is going on here.

Mr. ORSZAG. Let me comment on the unemployment projections. The unemployment projections this were embodied in the President's budget put forward in February were locked down in basically November and December of last year before we had information that the last quarter of last year was minus 6 percent, before there was information about just how weak the economic situation towards the end of last year was.

In the intervening period, it became obvious that the situation was worse than that. We are going to be updating our economic assumptions when we put out the mid-session review later this summer.

I would note about the path of the unemployment rate is that indicators suggest—and this is a small silver lining in an otherwise problematic trend—that part of the increase of the unemployment rate, a significant part reflects the part that people are no longer leaving the labor force but rather they are continuing to search for work. That elevates the unemployment rate, because, otherwise, they wouldn't even be counted. That part of it is actually encouraging, because it means people aren't completely giving up.

That having been said, clearly, the unemployment rate is elevated and the whole motivation by the Recovery Act was to help bring it down over time, even though the starting level was higher than we initially thought.

Mr. DIAZ-BALART. I understand that. But, again, kind of paraphrasing the Vice President—and I understand that. This is not a precise science. But, clearly, the estimates were wrong, flawed.

Mr. ORSZAG. Yeah. But that is independent of the Recovery Act.

Mr. DIAZ-BALART. I understand that. But it is evident that if you looked at the numbers what the administration was saying publicly and privately, unemployment—is it not accurate that unemployment numbers now are higher than the estimates were if we had not done anything?

Mr. ORSZAG. What I would say is—we locked down our economic projections in November or December of last year. Since then, I would say the economic outlook generally deteriorated based on what was happening at the end of last year. It since either kind of flattened or maybe if you look at private sector forecasts turned up slightly.

Comparing where we are now to when we locked things down, yes, it is worse now.

Mr. DIAZ-BALART. Thank you, sir.

Chairman SPRATT. Ms. DeLauro.

Ms. DELAURO. Thank you very much, Mr. Chairman.

Dr. Orszag, welcome again to the committee. Delighted to see you. I am going to be parochial in my questioning, and it is a subject that you and I have had conversations about before and that is the legislation which several of us have, the National Infrastructure Development Bank Act. And, as you know, it establishes a development bank to leverage private-sector dollars to invest in transportation, environmental, energy, and telecommunications infrastructure.

There is of late real momentum behind this concept, a concept that the President spoke about during the campaign and, in fact, was part of the budget submission.

I might add that, in terms of what this concept could do, given the leverage—and it was meant to have a $5 billion appropriations price tag for 5 years totaling $25 billion with paid-in capital, another $225 billion in callable capital from the Treasury, and a conservative leverage, which is what the European Investment Bank does, of about 2½ to 1 allowing the bank to issue up to $625 billion in 30-plus year bonds.

Aside from the economic recovery package, which was $787 billion to get this economy back on track, again, this is the largest sum of resources or the potential for resources to, in fact, do something about our infrastructure, make an attempt at capital budgeting, if you will, the first attempt to try to do that. And in addition to that to take this earmark project, process, which is not something that this administration looked favorably upon and a whole lot of our other colleagues on the other side of the aisle, except when it is their projects, but, in fact, it would depoliticize that process in a way to take us not only short term but long term to economic recovery and growth.

My question is—and you know all of that, but I needed to say it. In any case, do you have a sense of how the cost of this proposal should be measured and how your PAYGO proposal would apply to this effort?

Mr. ORSZAG. A couple comments.

First, as you know, the administration is working with the relevant committees on a possible approach to an infrastructure bank, and there are discussions that are ongoing. And, as you know, there were provisions made in the budget resolution for such an infrastructure bank. So just on the underlying idea, something that the administration does support.

As you know, the treatment of transportation, the transportation part of the budget, even for people who have spent years in the budget world, is a particularly complex and arcane area of budgeting. We have contract authority and special rules and odd limits and what have you. And my only point is it is not directly relevant to the statutory PAYGO legislation, but there are different rules that would apply. You could create, in theory, create an infrastructure bank that was not funded through——

Ms. DELAURO. That is what I am making reference to. Because this is a much wider portfolio. It is not just transportation. In fact, it is a bank and would be a separate entity, not supplant what transportation—the transportation bill does, but a separate entity.

Mr. ORSZAG. If the infrastructure bank had a call on the Federal Government, in other words, a free flow of money and the creation was just to set up a set of parameters and basically make it a mandatory program and then it would just evolve as the world evolved, that would presumably fall under statutory PAYGO.

Ms. DELAURO. Yes.

Mr. ORSZAG. I don't believe that is the way the existing proposals are structured, however.

Ms. DELAURO. In an answer to which earlier you said—I mean, this is a proposal that might contribute to the deficit in the immediate future, but its economic benefit in the long run of making what are significant investments for today and the future clearly outweigh—my view—outweigh the costs in terms of its ability to deal with those high unemployment numbers that we are talking about. And I don't know if those considerations can be applied to this effort.

We were only able to get about, over the next 2 years, about $7 billion as the budget was passed; and, clearly, in order to get to the 6¼ or over 6, you know, one has to take a look at what the size of the initial appropriations capital is. And obviously the concern is how it gets—how it can—the financing of this is critical and looking at it in terms of its ability to have one of the largest impacts in terms of the economic growth of this country for the long term, not a short-term economic recovery program but a long term.

So they can deal with high-speed rail, if you wanted to go back in history, an Erie Canal, the Rural Electrification Administration, all of which had an enormous impact on the economy of this Nation. And I would hope that we could have some way in which we could look at making this a reality instead of a, you know, a vision or a blueprint.

Chairman SPRATT. Ms. McCollum.

Ms. MCCOLLUM. Thank you, Mr. Chair.

I am going to read back to you from your first paragraph, because I think it is important to go back to basics. There has been a lot of discussion and people trying to get their points across, but I want to make sure that I clearly understand the point that you are getting across to me. Because I have to say, I believe in it.

You started out with saying, the PAYGO Act would hold us to a simple but important principle: We should pay for new tax or entitlement legislation. Creating a new non-emergency tax cut or entitlement expansion would require offsetting revenue increases or spending reductions.

So I am going to have two questions. My first question is going to be, why should PAYGO apply to both sides, both revenues and spending? Because that is one of the reasons why I didn't vote for the tax cuts 8 years ago, because I didn't see that we were being honest and transparent about the effect it was going to have on the economy.

The second part of your first paragraph is, in the 1990s, statutory PAYGO encouraged the tough decisions that helped move the

government from large deficits to surpluses. I believe it can do the same today.

So if PAYGO only applies to new legislation and not budgetary costs we already included in the baseline, does PAYGO still make sense? And I believe it does. So could you restate again how this isn't the solution to every problem that we are facing, but it stops us from digging the hole deeper?

Mr. ORSZAG. On your first question, the reason PAYGO needs to apply to both sides of the budget is that a reduction in revenue of a dollar has the same impact on public debt and the evolution of our fiscal future as an increase of spending of $1. And, in fact, if you exempted the revenue side of the budget, it is the easiest thing in the world to create a tax credit that does something that is very similar to a spending program, and you create then a substantial bias towards doing things in one form rather than the other, even though there may not be an underlying rationale for doing so. So it is both that revenue reductions increase the deficit, and also that you would create a sort of policy problem in how—in incentives for creating new proposals in one way as opposed to another.

Now, it is looking forward. It is the case that all PAYGO does is make sure we don't make things worse. But that is not a trivial thing for two reasons. One is there has been a period of time when we did make things much worse.

Again, I want to come back—our long-term fiscal gap over 75 years is about 7 percent or so of the economy. Three percent of that, almost half, comes from policies that were enacted since 2000 and not offset.

So we basically doubled the size of our long-term fiscal gap by putting income place a bunch of policies and not offsetting them. We can't do that again, and that is an important thing.

I go beyond that and say I have what has been described as the broken window of budgeting, which is having that discipline in place helps create a culture in which you can do even more than that. And not having that in place, just like a broken window, has been shown to increase crime. Even though it may not be the mechanism through which the crime occurs, not having it in place creates this era of anything goes that would be highly problematic.

Chairman SPRATT. Mr. Langevin is not here.

Mr. Boyd of Florida.

Mr. BOYD. Thank you, Mr. Chairman.

Director Orszag, thank you, sir, for your service and your advocacy for this fiscal discipline tool that we are discussing today.

I was interested in some of the comments earlier about the overspending that happened in the previous administration and some criticism of the fact that that didn't necessarily mean we had to do that now, and I agree with that in part. But I notice you were asked earlier by Ms. Lummis about the administration's intent to instill discipline on the discretionary spending side.

I would like for you to answer two questions for me, if you could. One is, what is the total amount of discretionary spending, and how much of that is defense? And, secondly, if you could, walk us through what would have happened in terms of the spending that we put in place, the tax cuts and the spending that we put in place since the expiration of PAYGO in 2002 if PAYGO had not expired

and the Congress and the administration would have had to comply with PAYGO rules. I assume that that would have applied to the 2003 tax cuts; it would have applied to the Medicare prescription drug program; it would apply to all the AMT fixes, FGR fixes. All of those issues. Can you walk us through what we would look like today if PAYGO had not been allowed to expire?

Mr. ORSZAG. Sure.

First, with regard to discretionary spending in 2010, we project $1.26 trillion in discretionary spending, $687 billion of which—in other words, more than half—is for the Defense Department, including funding for overseas' contingencies operations.

Mr. BOYD. Does that include Homeland Security?

Mr. ORSZAG. Homeland Security is actually in the non-defense part of the budget. So some of the numbers that are discussed about the increase in non-defense discretionary spending reflect not only the Census but also Homeland Security.

Non-defense discretionary spending is projected to be $573 billion.

With regard to policies that were put in place since the PAYGO rules were expired, I would also first note when they were waived right before they expired—and on that basis, again, I am going to come back to we are talking about hundreds of billion of dollars this year in policies that were adopted, not offset. If you threw in interest, it would be even more, because the rules were not either abided by or didn't exist.

For the policies that were adopted since 2002, when you look at the 2003 tax legislation, the prescription drug benefit in particular, you are talking about well over a percent of GDP in offset costs. And so you are again talking about well more than a hundred billion dollars a year and perhaps in the hundreds of billions of dollars a year in policies that were adopted and not offset.

Mr. BOYD. So from that we could conclude that if we had those fiscal discipline rules in place and we abided by them, we would have been in much better shape today than we are.

Mr. ORSZAG. No doubt about it.

Mr. BOYD. Mr. Chairman, thank you.

Chairman SPRATT. Mr. Berry.

Mr. BERRY. Thank you, Mr. Chairman; and thank you, Dr.

Orszag, for being here and your service and all of the good things that you have done.

My question is, there is an increase in the money supply that the Congress has nothing to do with; isn't that correct?

Mr. ORSZAG. Yes, sir. Well, only in the sense that you originally created the Federal Reserve.

Mr. BERRY. And authorized them to do such things. But we have not lately had anything do with that.

Mr. ORSZAG. Yeah.

Mr. BERRY. When that money supply is increased, is there any basis for the value of it, other than the good faith and credit of the United States?

Mr. ORSZAG. I guess what I would say is that the underlying rate of inflation can be viewed in a variety of different ways. One of the things that influences it is the rate at which the money supply is increased.

Mr. BERRY. How does the amount that the money supply has been increased compare to the amount of money that we have authorized and appropriated by the Congress since the crisis began, let us say, last Labor Day?

Mr. ORSZAG. There has been a very—instead of measuring it in terms of direct money creation—and there are different measures of money—if you look at the expansion of the Fed's balance sheet, that has actually exceeded the Recovery Act funds that have flowed to date, for example, and many of the other steps that have been taken.

Mr. BERRY. Do you have any idea how much it is?

Mr. ORSZAG. North of a trillion dollars in terms of expansion.

Mr. BERRY. Okay. Thank you.

Thank you, Mr. Chairman.

Chairman SPRATT. I believe that completes our questioning for Mr. Orszag. Thank you very much for coming.

But, before you leave, I would look for you to take one question for the record.

Mr. ORSZAG. Sure.

Chairman SPRATT. The legislative proposal you submitted lists mandatory accounts that would be exempt from sequestration but does not list those accounts that would be subject to sequestration. For the record and for our purposes, could you provide us with a list of those programs that would be subject to sequestration and a list of those that would not be subject, along with a dollar amount estimated for each?

Mr. ORSZAG. I could even take that out of my binder and hand it to you now, but we will provide it in writing.

[The information follows:]

A bill to reinstitute and update the Pay-As-You-Go requirement of budget neutrality on new tax and mandatory spending legislation, enforced by the threat of annual, automatic sequestration.

SECTION 1. SHORT TITLE AND TABLE OF CONTENTS.

(a) Short Title.—This Act may be cited as the "Statutory Pay-As-You-Go Act of 2009".

(b) Table of Contents.

Section 1. Short Title and Table of Contents
Section 2. Purpose and Expiration
Section 3. Definitions
Section 4. PAYGO Estimates and PAYGO Ledger
Section 5. Annual Report and Sequestration Order
Section 6. Calculating a Sequestration
Section 7. Special, Temporary Rule to Reflect Current Policy
Section 8. Application of BBEDCA
Section 9. Amendments to the Baseline
Section 10. Technical Corrections
Section 11. Conforming Amendments
Section 12. Exempt Programs and Activities

SECTION 2. PURPOSE AND EXPIRATION.

(a) Purpose.—The purpose of this Act is to re-establish a statutory procedure to enforce a rule of budget neutrality on new tax and mandatory spending legislation enacted through the end of calendar year 2013, by creating an automatic statutory penalty that Congress and the President will seek to avoid.

(b) Expiration.—Sections 1 through 8 of this Act shall expire on the later of December 31, 2013, or the issuance and implementation of a sequestration order for fiscal year 2014 if one is required by this Act.

SECTION 3. DEFINITIONS.

As used in this Act——

(1) The term "BBEDCA" means the Balanced Budget and Emergency Deficit Control Act of 1985, as amended including by this Act.

(2) The terms "appropriations Act", "budget authority", and "outlays" have the meanings given to them in section 3 of the Congressional Budget and Impoundment Control Act of 1974.

(3) The terms "baseline", "budget year", "CBO", "current year", "deposit insurance", "OMB", "sequester", and "sequestration" have the meanings given to them in section 250 of BBEDCA.

(4) The term "AMT" means the Alternative Minimum Tax for individuals under sections 55-59 of the Internal Revenue Code of 1986, the term "EGTRRA" means the Economic Growth and Tax Relief Reconciliation Act of 2001 (Public Law 107-16), and the term "JGTRRA" means the Jobs and Growth Tax Relief and Reconciliation Act of 2003 (Public Law 108-27).

(5) The term "budgetary effects" means the amounts by which PAYGO legislation changes mandatory outlays or revenues relative to the baseline. Budgetary effects that increase mandatory outlays or decrease revenues are termed "costs" and budgetary effects that increase revenues or decrease mandatory outlays are termed "savings". For purposes of these definitions, off-budget effects and debt service effects are not counted as budgetary effects.

(6) The term "debit" refers to the net total amount, when positive, by which costs recorded on the PAYGO ledger for a fiscal year exceed savings recorded on that ledger for that year.

(7) The term "discretionary programs" refers to programs funded though appropriations Acts other than mandatory programs.

(8) The term "entitlement law" means the statutory mandate or requirement of the United States to incur a financial obligation unless that obligation is explicitly conditioned on the appropriation in subsequent legislation of sufficient funds for that purpose.

(9) The term "mandatory outlays" refers to outlays flowing from (A) budget authority provided by laws other than appropriations Acts, (B) entitlement laws, or (C) the Supplemental Nutrition Assistance Program, and the term "mandatory programs" refers to programs that produce mandatory outlays.

(10) The term "outyear" means a fiscal year that occurs one or more years after the budget year.

(11) The term "PAYGO ledger" refers to a table maintained by OMB (A) containing a column for each fiscal year 2010 through 2014 and recording in the applicable column or columns the average of the budgetary effects of each PAYGO Act enacted after the enactment of this Act and before January 1, 2014, and (B) displaying the net sum for each of those fiscal years of the average budgetary effects of all such Acts.

(12) The term "PAYGO legislation" or a "PAYGO Act" refer to legislation that is scored as increasing or decreasing governmental receipts or mandatory outlays relative to the baseline, except that when those budgetary effects are caused by substantive legislative provisions in appropriations Acts, the current-year and budget-year effects of those provisions are not considered PAYGO legislation.

(13) The term "timing shift" refers to a delay of the date on which mandatory outlays would otherwise occur from the ninth outyear to the tenth outyear or an acceleration of the date on which revenues or offsetting receipts or collections would otherwise occur from the tenth outyear to the ninth outyear.

SECTION 4. PAYGO ESTIMATES AND PAYGO LEDGER.

(a) CBO Estimates.—As soon as practicable after Congress completes action on any PAYGO legislation, CBO shall provide an estimate of its budgetary effects to OMB.

(b) PAYGO Ledger.—OMB shall maintain and make publicly available a document containing a PAYGO ledger and, not later than 7 days (excluding weekends and legal holidays) after the enactment of any PAYGO legislation, OMB shall record on that ledger its estimate of the legislation's budgetary effects in each fiscal year, applying the look-back requirement of subsection (e) and the averaging requirement of subsection (h). The document shall also explain any major differences between the OMB and CBO estimates of the budgetary effects of PAYGO legislation.

(c) Basis of OMB Estimates.—When estimating and recording the budgetary effects of a PAYGO Act, OMB shall employ economic and technical assumptions consistent with those in the President's most recent Budget submitted under 31 U.S.C. §1105 and shall use probabilistic methods where appropriate. Once it enters budgetary effects on the ledger, OMB shall not change the entries other than to correct errors. OMB's assumptions, data, determinations, estimates, and methodology under this Act are not subject to review in any judicial or administrative proceedings.

(d) Current Policy Exceptions for Certain Legislation.—Notwithstanding the definitions in paragraphs (5), (11), and (12) of section 3, OMB estimates of provisions of legislation within the four areas of the budget identified in section 7 shall be entered on the PAYGO scorecard as specified in that section, and the estimates so entered shall be treated as the budgetary effects of PAYGO legislation for purposes of this section.

(e) Look-Back to Capture Current-Year Effects.—For purposes of this section, OMB shall treat the budgetary effects of PAYGO legislation enacted during a session of Congress that occur during the current year as though they occurred in the budget year.

(f) Timing Shifts.—For purposes of this section, OMB and CBO shall not count timing shifts in their estimates of the budgetary effects of PAYGO legislation.

(g) Emergency Legislation.—If a provision of PAYGO legislation is enacted that the President designates as an emergency requirement and that the Congress so designates in statute, OMB shall display the budgetary effects of that provision as an addendum in the document containing the PAYGO ledger but shall not record the budgetary effects in the ledger itself.

(h) Averaging Used to Measure Compliance Over Ten Years.—OMB shall cumulate the budgetary effects of a PAYGO Act over the budget year (which includes any look-back effects under subsection (e)) and the nine subsequent outyears, divide that cumulative total by ten, and enter the quotient in the budget-year column of the PAYGO ledger and in each subsequent column, if any, through the column for 2014.

(i) Scorekeeping Guidelines.—OMB and CBO shall prepare estimates under this paragraph in conformance with scorekeeping guidelines determined after consultation among the House and Senate Committees on the Budget, CBO, and OMB.

(j) Treatment of Program Conversions.—For purposes of this section, and notwithstanding other provisions of this Act——

(1) If legislation converts an identifiable element of a mandatory program into a discretionary program (with that program element or a substantially similar one continuing to be authorized), OMB and CBO shall not score the conversion of that element as reducing mandatory outlays.

(2) If legislation converts an identifiable element of a discretionary program into a mandatory program, OMB and CBO shall estimate the legislation's budgetary effects in each year by subtracting the discretionary baseline levels of that element from the amount by which that legislation increases mandatory outlays in that year.

SECTION 5. ANNUAL REPORT AND SEQUESTRATION ORDER.

(a) Annual Report.—No later than 14 days (excluding weekends and holidays) after Congress adjourns to end a session, OMB shall make publicly available an annual PAYGO report and publish in the Federal Register a notice of the report and information on how it can be obtained. The report shall include an up-to-date document containing a PAYGO ledger and information about estimating differences as required by section 4(b), a description of and justification for any current policy exceptions made under section 4(d), information about emergency legislation (if any) required by section 4(g), information about any sequestration if required by subsection (b), and other data and explanations that enhance public understanding of this Act and actions taken under it. If Congress does not adjourn to end a session, then for the purposes of this Act it shall be deemed to have done so on December 31 of that session.

(b) Sequestration Order.—If the annual report issued at the end of a session of Congress under subsection (a) shows a debit on the PAYGO ledger for the budget year, OMB shall prepare and the President shall issue an order sequestering budgetary resources from mandatory programs by enough to fully offset that debit, as prescribed in section 6. OMB shall include that order in the annual report and transmit it to the House of Representatives and the Senate. If the President issues a sequestration order, the annual report shall contain, for each budget account to be sequestered, estimates of the baseline level of budgetary resources subject to sequestration, the amount of budgetary resources to be sequestered, and the outlay reductions that will occur in the budget year and the subsequent fiscal year because of that sequestration.

SECTION 6. CALCULATING A SEQUESTRATION.

(a) Sequestration Base.—For purposes of this section, OMB shall assume that mandatory programs are at the levels in the baseline before the implementation of the sequestration order.

(b) Reducing Non-Exempt Budgetary Resources by a Uniform Percentage.—OMB shall calculate the uniform percentage by which the budgetary resources of non-exempt mandatory programs are to be sequestered such that the outlay savings resulting from that sequestration, as calculated under subsection (c), shall fully offset the

budget-year debit on the PAYGO ledger, if any. If the uniform percentage calculated under the prior sentence exceeds 4 percent, the Medicare programs described in section 256(d) of BBEDCA shall be reduced by 4 percent and the uniform percentage by which the budgetary resources of all other non-exempt mandatory programs are to be sequestered shall be increased, as necessary, so that the sequestration of Medicare and of all other non-exempt mandatory programs together produces the required outlay savings.

(c) Outlay Savings.—In determining the amount by which a sequestration offsets a budget-year debit, OMB shall count——

(1) the amount by which the sequestration in a crop year of crop support payments, pursuant to section 256(j) of BBEDCA, reduces outlays in the budget year and the subsequent fiscal year;

(2) the amount by which the sequestration of Medicare payments in the 12-month period following the sequestration order, pursuant to section 256(d) of BBEDCA, reduces outlays in the budget year and the subsequent fiscal year; and

(3) the amount by which the sequestration in the budget year of the budgetary resources of other non-exempt mandatory programs reduces mandatory outlays in the budget year and in the subsequent fiscal year.

SECTION 7. SPECIAL, TEMPORARY RULE TO REFLECT CURRENT POLICY.

(a) Purpose.—The purpose of this section is to establish a temporary rule addressing the scoring of legislation affecting four areas of the budget and superseding the scoring rules otherwise provided by this Act to the extent they are inconsistent. The four areas covered by this section are——

(1) payments made under section 1848 of the Social Security Act (titled Payment for Physicians' Services),

(2) the Estate and Gift Tax under subtitle B of the Internal Revenue Code of 1986,

(3) the AMT, and

(4) provisions of EGTRRA or JGTRRA that amended the Internal Revenue Code of 1986 (or provisions in later statutes further amending the amendments made by EGTRRA or JGTRRA), other than——

(A) the provisions of those two Acts that were made permanent by the Pension Protection Act of 2006 (Public Law 109-280),

(B) amendments to the estate and gift tax referred to in paragraph (2), and

(C) the AMT referred to in paragraph (3).

(b) Duration.—This section shall remain in effect through December 31, 2010, for each of the four areas specified in subsection (a), except that if the President determines that legislation sufficiently consistent with current policy as described in subsection (c)(2) has not been enacted in one or more of those four areas by that date, the provisions of this section will remain in effect with respect to that area or those areas until such legislation has been enacted or until December 31, 2011, whichever occurs sooner.

(c) Current Policy Projection and Initial Current Law Projections.——

(1) For purposes of this section, the budgetary effects of legislation of the type referred to in subsection (a) shall be estimated relative to the baseline under section 257 of BBEDCA but the budgetary effects of that legislation shall be entered on the PAYGO ledger only to the extent that they fall outside a range bounded by the current policy projection under paragraph (2) and the initial current law projection under paragraph (3), as specified under subsections (d), (e), or (f), as applicable. Each of those two boundary projections shall be estimated using the policy assumptions stated in paragraph (2) or (3) as applicable, regardless of the enactment of subsequent legislation, but the estimates of the dollar levels of those two boundary projections shall change——

(A) when economic and technical assumptions change with the issuance of a new budget under 31 U.S.C. 1105,

(B) with changes in the assumed effective date of the legislation that is measured against those two projections, and

(C) to the extent the policy assumptions under either of those two projections interact with other aspects of law, when legislation affecting those other aspects of law is enacted.

With respect only to legislation affecting the AMT or the amendments to provisions of the income tax referred to in subsection (a)(4), the dollar levels of those two boundary projections shall be estimated separately, and the determination of whether and the extent to which budgetary effects fall outside the boundaries shall be made separately, for each separate provision within that legislation.

(2) During the period specified in subsection (b), there shall exist a current policy projection in addition to the baseline specified in section 257 of BBEDCA. This projection shall——

(A) with respect to payments made under section 1848 of the Social Security Act, assume that the applicable payment rates and payment policies in effect for 2009 remain in effect thereafter without change;

(B) with respect to the estate and gift tax, assume that the tax rates, nominal exemption amounts, and related parameters in effect for tax year 2009 remain in effect thereafter without change;

(C) with respect to the AMT, assume that the exemption amounts and related parameters in effect for tax year 2009 are increased in each subsequent year by an amount equal to the cost-of-living adjustment determined under section 1(f)(3) of the Internal Revenue Code of 1986 for the calendar year in which the taxable year begins, determined by substituting "calendar year 2008" for "calendar year 1992" in subparagraph (B) thereof ; and

(D) with respect to the income tax provisions referred to in subsection (a)(4), assume that each such separate provision scheduled on June 8, 2009, to be in effect for tax year 2010 remains in effect thereafter without change, other than applicable indexing.

(3) Initial Current Law Projection.—During the period specified in subsection (b), there shall exist an initial current law projection in addition to the baseline specified in section 257 of BBEDCA. This projection shall——

(A) with respect to payments made under section 1848 of the Social Security Act, assume that the applicable payment rates and payment policies scheduled on June 8, 2009, to be in effect for each subsequent fiscal year shall be in effect as scheduled;

(B) with respect to the estate and gift tax, assume that the tax rates, nominal exemption amounts, and related parameters scheduled on June 8, 2009, to be in effect for each subsequent tax year shall be in effect as scheduled;

(C) with respect to the AMT, assume that the exemption amounts and related parameters scheduled on June 8, 2009, to be in effect for each subsequent tax year shall be in effect as scheduled; and

(D) with respect to provisions of the income tax referred to in subsection (a)(4), assume that each such provision scheduled on June 8, 2009, to be in effect for each subsequent tax year shall be in effect as scheduled.

(d) Budgetary Effects of Certain Medicare Legislation.—Notwithstanding the definitions in paragraphs (5), (11), and (12) of section 3, OMB shall enter on the PAYGO ledger the budgetary effects of any provision of PAYGO legislation that amends or supersedes the system of payments under section 1848 of the Social Security Act——

(1) only to the extent that the level of net Medicare outlays are estimated to be higher in a fiscal year than if that provision of PAYGO legislation had instead enacted (or maintained) the current policy projection, or

(2) only to the extent that the level of net Medicare outlays are estimated to be lower in a fiscal year than if that provision of PAYGO legislation had instead enacted (or maintained) the initial current law projection.

(e) Budgetary Effects of Estate and Gift Tax Legislation.—Notwithstanding the definitions in paragraphs (5), (11), and (12) of section 3, OMB shall enter on the PAYGO ledger the budgetary effects of any provision of PAYGO legislation that amends the estate and gift tax——

(1) only to the extent that total revenues in a fiscal year are estimated to be changed because tax liability under the estate and gift tax is estimated to be higher in tax year 2010 than if that provision of PAYGO legislation had instead enacted (or maintained) the current policy projection,

(2) only to the extent that total revenues in a fiscal year are estimated to be changed because tax liability under the estate and gift tax is estimated to be lower in tax year 2010 than if that provision of PAYGO legislation had instead enacted (or maintained) the initial current law projection,

(3) only to the extent that total revenues in a fiscal year are estimated to be changed because tax liability under the estate and gift tax is estimated to be lower in a tax year after 2010 than if that provision of PAYGO legislation had instead enacted (or maintained) the current policy projection, or

(4) only to the extent that total revenues in a fiscal year are estimated to be changed because tax liability under the estate and gift tax is estimated to be higher in a tax year after 2010 than if that provision of PAYGO legislation had instead enacted (or maintained) the initial current law projection.

(f) Budgetary Effects of AMT and Certain Income Tax Legislation Taken Separately; Stacking Order and Interactive Effects.—Notwithstanding the definitions in paragraphs (5), (11), and (12) of section 3, OMB shall enter on the PAYGO ledger

the budgetary effects of any PAYGO legislation that amends the AMT or amends one of the income tax provisions referred to in subsection (a)(4)——

(1) only to the extent that the level of income tax revenues is estimated to be lower and the level of outlays for refundable tax credits is estimated to be higher in a fiscal year than if that PAYGO legislation had instead enacted (or maintained) the current policy projection with respect to that provision of the income tax, or

(2) only to the extent that the level of income tax revenues is estimated to be higher and the level of outlays for refundable tax credits is estimated to be lower in a fiscal year than if that PAYGO legislation had instead enacted (or maintained) the initial current law projection with respect to that provision of the income tax.

In making estimates under this section of the budgetary effects of a PAYGO Act that amends both the AMT and at least one separate provision of the income tax, or amends more than one separate provision of the income tax, OMB shall first estimate the budgetary effects of any amendment to the AMT contained in that Act, and shall then estimate the budgetary effects of each remaining amendment to the income tax contained in that Act as though any AMT amendments contained in that Act and the preceding amendments made by that Act had been enacted but the succeeding amendments had not. For purposes of this section, each separate income tax rate shall be considered a separate provision.

SECTION 8. APPLICATION OF BBEDCA.

For purposes of this Act——

(1) notwithstanding section 275 of BBEDCA, the provisions of sections 255, 256, and 257 of BBEDCA, as amended by this Act, shall apply to the provisions of this Act;

(2) references in sections 255, 256 and 257 to "this part" shall be interpreted as applying to this Act;

(3) references in sections 255, 256 and 257 of BBEDCA to "section 254" shall be interpreted as referencing section 5 of this Act;

(4) the reference in section 256(b) of BBEDCA to "section 252 or 253" shall be interpreted as referencing section 5 of this Act;

(5) the reference in section 256(d)(1) of BBEDCA to "section 252 or 253" shall be interpreted as referencing section 6 of this Act;

(6) the reference in section 256(d)(4) of BBEDCA to "section 252 or 253" shall be interpreted as referencing section 5 of this Act;

(7) section 256(k) of the BBEDCA shall apply to a sequestration, if any, under this Act;

(8) references in section 257(e) to "section 251, 252, or 253" shall be interpreted as referencing section 4 of this Act; and

(9) the term "direct spending" in section 257 of BBEDCA shall be interpreted as applying to mandatory programs or the funding for mandatory programs, as appropriate.

SECTION 9. AMENDMENTS TO THE BASELINE.

In section 257 of BBEDCA——

(a) Strike "entitlement authority" and insert in lieu thereof "entitlement laws".

(b) Amend subsection (b)(2)(A) to read——

"(A) If any law expires before the budget year or before any outyear, then any program with estimated current-year outlays of more than $50,000,000 operating under that law is assumed to continue to operate under that law as in effect immediately before its expiration. For purposes of the preceding sentence, the Food, Conservation, and Energy Act of 2008 or a similar successor act is treated as a program assumed to be continued after its scheduled expiration.".

(c) Amend subsection (b)(2)(D) to read——

"Payments of social insurance, deposit insurance, pension insurance, and any similar statutory financial insurance guarantees are assumed to be made in full regardless of the sufficiency of the funds supporting those programs, and funding for flood insurance and any similar contractual insurance programs is assumed to be sufficient to fulfill existing contracts.".

(d) Amend subsection (c)(1) by striking "Budgetary resources" and inserting in lieu thereof "Except as provided in subsection (d), budgetary resources" and by striking "to offset pay absorption and for pay annualization" and inserting in lieu thereof "to adjust Pell grant funding".

(e) Amend subsection (c)(2) to read——

"(2) EXPIRING HOUSING CONTRACTS.—New budget authority shall be added to the baseline in the budget year and the outyears to cover the costs of renewing expiring subsidized housing contracts that were funded in the current year under multiyear contracts whose budget authority was recorded in years prior to the current year. The amount added (before adjusting for inflation) shall be the amount

needed to renew the expiring contracts through an uninterrupted series of 12-month contracts, assuming unchanged rental or equivalent prices.".

(f) Amend subsection (c) (4) to read——

"(4) PELL GRANTS.—Notwithstanding paragraph (1), new budget authority for the Pell grant program shall be included in the baseline in an amount sufficient to cover the costs of the program at the maximum award level specified in the most recently enacted full-year appropriations Act, the budget authority in the budget year shall be adjusted for any cumulative funding shortfall or surplus from prior academic years, and the adjustment for inflation under paragraph (5) shall not apply.".

(g) Insert after subsection (c) the following, and redesignate the subsequent subsections accordingly——

"(d) DISASTERS.—Notwithstanding subsections (b) and (c), temporary mandatory funding and tax provisions related to major natural or man-made disasters shall be assumed to expire on schedule, and discretionary funding for major natural or man-made disaster shall not be projected. In lieu, the baseline shall include a disaster allowance that is not designated as mandatory or discretionary and is not allocated to any committee of Congress. The amount of budget authority assumed for this disaster allowance shall equal a probabilistic estimate of the amount of federal exposure to the risk of major natural or man-made disasters occurring in the remainder of the current year, the budget year, and each outyear, and the amount of outlays shall equal the estimated expenditures of that budget authority. Major disasters shall include disaster costs other than those normally covered by routine firefighting funding and normal and ongoing costs of disaster agencies, programs, or activities.".

SECTION 10.—TECHNICAL CORRECTIONS.

(1) Section 250(c)(18) of BBEDCA is amended by striking "the expenses the Federal deposit insurance agencies" and inserting "the expenses of the Federal deposit insurance agencies".

(2) Section 256(k)(1) of BBEDCA is amended by striking "in paragraph (5)" and inserting "in paragraph (6)".

SECTION 11.—CONFORMING AMENDMENTS.

(a) Section 256(a) of BBEDCA is repealed.

(b) Section 256(b) of BBEDCA is amended by striking "origination fees under sections 438(c)(2) and 455(c) of that Act shall each be increased by 0.50 percentage point." and inserting in lieu thereof "origination fees under sections 438(c)(2) and (6) and 455(c) and loan processing and issuance fees under section 428(f)(1)(A)(ii) of that Act shall each be increased by the uniform percentage specified in that sequestration order, and, for student loans originated during the period of the sequestration, special allowance payments under section 438(b) of that Act accruing during the period of the sequestration shall be reduced by the uniform percentage specified in that sequestration order.".

(c) Section 256(c) of BBEDCA is repealed.

(d) Section 256(d) of BBEDCA is amended——

(1) by redesignating paragraphs (2), (3), and (4) as paragraphs (3), (5), and (6);

(2) in paragraph (1) to read as follows:

"(1) CALCULATION OF REDUCTION IN PAYMENT AMOUNTS.—To achieve the total percentage reduction in those programs required by section 252 or 253, subject to paragraph (2), and notwithstanding section 710 of the Social Security Act, OMB shall determine, and the applicable Presidential order under section 254 shall implement, the percentage reduction that shall apply, with respect to the health insurance programs under title XVIII of the Social Security Act——

"(A) in the case of parts A and B of such title, to individual payments for services furnished during the one-year period beginning on the first day of the first month beginning after the date the order is issued (or, if later, the date specified in paragraph (4)), and

"(B) in the case of parts C and D, to monthly payments under contracts under such parts for the same one-year period,

such that the reduction made in payments under that order shall achieve the required total percentage reduction in those payments for that period.";

(3) by inserting after paragraph (1) the following:

"(2) UNIFORM REDUCTION RATE; MAXIMUM PERMISSIBLE REDUCTION.—Reductions in payments for programs and activities under such title XVIII pursuant to a sequestration order under section 254 shall be at a uniform rate, which shall not exceed 4 percent, across all such programs and activities subject to such order.";

(4) by inserting after paragraph (3), as so redesignated, the following:

"(4) TIMING OF SUBSEQUENT SEQUESTRATION ORDER.—A sequestration order required by section 252 or 253 with respect to programs under such title XVIII

shall not take effect until the first month beginning after the end of the effective period of any prior sequestration order with respect to such programs, as determined in accordance with paragraph (1).";

(5) in paragraph (6), as so redesignated, to read as follows:

"(6) SEQUESTRATION DISREGARDED IN COMPUTING PAYMENT AMOUNTS.—The Secretary of Health and Human Services shall not take into account any reductions in payment amounts which have been or may be effected under this part, for purposes of computing any adjustments to payment rates under such title XVIII, specifically including——

"(A) the part C growth percentage under section 1853(c)(6);

"(B) the part D annual growth rate under section 1860D-2(b)(6); and

"(C) application of risk corridors to part D payment rates under section 1860D-15(e)."; and

(6) by adding after paragraph (6), as so redesignated, the following:

"(7) EXEMPTIONS FROM SEQUESTRATION.—In addition to the programs and activities specified in section 255, the following shall be exempt from sequestration under this part:

"(A) PART D LOW-INCOME SUBSIDIES.—Premium and cost-sharing subsidies under section 1860D-14 of the Social Security Act.

"(B) PART D CATASTROPHIC SUBSIDY.—Payments under section 1860D-15(b) and (e)(2)(B) of the Social Security Act.

"(C) QUALIFIED INDIVIDUAL (QI) PREMIUMS.—Payments to States for coverage of Medicare cost-sharing for certain low-income Medicare beneficiaries under section 1933 of the Social Security Act.".

SECTION 12. EXEMPT PROGRAMS AND ACTIVITIES.

(a) Designations.—Section 255 of BBEDCA is amended by redesignating paragraph (i) as (j) and striking "1998" and inserting in lieu thereof "2010".

(b) Social Security, Veterans Programs, Net Interest, and Tax Credits.—Subsections (a) through (d) of section 255 of BBEDCA are amended to read as follows——

"(a) SOCIAL SECURITY BENEFITS AND TIER I RAILROAD RETIREMENT BENEFITS.—Benefits payable under the old-age, survivors, and disability insurance program established under title II of the Social Security Act (Title 42, United States Code, section 401 et seq.), and benefits payable under section 231b(a), 231b(f)(2), 231c(a), and 231c(f) of Title 45 United States Code, shall be exempt from reduction under any order issued under this part.

"(b) VETERANS PROGRAMS.—The following programs shall be exempt from reduction under any order issued under this part:

Canteen Service Revolving Fund (36-4014-0-3-705);

National Service Life Insurance Fund (36-8132-0-7-701);

Native American Veteran Housing Loan Program (36-1120-0-1-704);

Service-Disabled Veterans Insurance Fund (36-4012-0-3-701);

Veterans Insurance and Indemnities (36-0120-0-1-701);

Veterans Reopened Insurance Fund (36-4010-0-3-701);

Veterans Special Life Insurance Fund (36-8455-0-8-701);

United States Government Life Insurance Fund (36-8150-0-7-701);

Benefits under chapter 21 of title 38, United States Code, relating to specially adapted housing and mortgage-protection life insurance for certain veterans with service-connected disabilities (36-0120-0-1-701);

Compensation and Pensions (36-0102-0-1-701) to include Burial Benefits under Chapter 23 of Title 38;

Benefits under chapter 33 of title 38, United States Code, relating to educational assistance provided by the Post-9/11 Educational Assistance Act of 2008 (36-0137-0-1-702);

Benefits under chapter 39 of title 38, United States Code, relating to automobiles and adaptive equipment for certain disabled veterans and members of the Armed Forces (36-0137-0-1-702);

Benefits under chapter 35 of title 38, United States Code, related to educational assistance for survivors and dependents of certain veterans with service-connected disabilities (36-0137-0-1-702);

Assistance and services under chapter 31 of title 38, United States Code, relating to training and rehabilitation for certain veterans with service-connected disabilities (36-0137-0-1-702);

Benefits under subchapters I, II, and III of chapter 37 of title 38, United States Code, relating to housing loans for certain veterans and for the spouses and surviving spouses of certain veterans Housing Program Account (36-1119-0-1-704); and

Special Benefits for Certain World War II Veterans (28-0401-0-1-701);.

"(c) NET INTEREST.—No reduction of payments for net interest (all of major functional category 900) shall be made under any order issued under this part.

"(d) REFUNDABLE INCOME TAX CREDITS.—Payments to individuals made pursuant to provisions of the Internal Revenue Code of 1986 establishing refundable tax credits shall be exempt from reduction under any order issued under this part.".

(c) Other Programs and Activities, Low-Income Programs, and Economic Recovery Programs.—Subsections (g) and (h) of section 255 of BBEDCA are amended to read as follows——

"(g) OTHER PROGRAMS AND ACTIVITIES.——

(1)(A) The following budget accounts and activities shall be exempt from reduction under any order issued under this part:

Activities resulting from private donations, bequests, or voluntary contributions to the Government;

Activities financed by voluntary payments to the Government for goods or services to be provided for such payments;

Administration of Territories, Northern Mariana Islands Covenant grants (14-0412-0-1-808);

Advances to the Unemployment Trust Fund and Other Funds (16-0327-0-1-600);

Appropriations for the District of Columbia (to the extent they are appropriations of locally raised funds);

Black Lung Disability Trust Fund Refinancing (16-0329-0-1-601);

Bonneville Power Administration Fund and borrowing authority established pursuant to section 13 of Public Law 93-454 (1974), as amended (89-4045-0-3-271);

Claims, Judgments, and Relief Acts (20-1895-0-1-808);

Colorado River Basins Power Marketing Fund, Western Area Power Administration, (89-4452-0-3-271);

Compact of Free Association (14-0415-0-1-808);

Compensation of the President (11-0209-0-1-802);

Construction, Rehabilitation, Operation and Maintenance, Western Area Power Administration (89-5068-0-2-271);

Comptroller of the Currency, Assessment Funds (20-8413-0-8-373);

Continuing Fund, Southeastern Power Administration (89-5653-0-2-271);

Continuing Fund, Southwestern Power Administration (89-5649-0-2-271);

Dual Benefits Payments Account (60-0111-0-1-601);

Emergency Fund, Western Area Power Administration (89-5069-0-2-271);

Exchange Stabilization Fund (20-4444-0-3-155);

Federal Deposit Insurance Corporation, Deposit Insurance Fund (51-4596-4-4-373);

Federal Deposit Insurance Corporation, FSLIC Resolution Fund (51-4065-0-3-373);

Federal Deposit Insurance Corporation, Non-Interest Bearing Transaction Account Guarantee (51-4458-0-3-373);

Federal Deposit Insurance Corporation, Office of Inspector General (51-4595-0-4-373);

Federal Deposit Insurance Corporation, Senior Unsecured Debt Guarantee (51-4457-0-3-373);

Federal Housing Finance Agency, Administrative Expenses (95-5532-0-2-371);

Federal Payment to the District of Columbia Judicial Retirement and Survivors Annuity Fund (20-1713-0-1-752);

Federal Payment to the District of Columbia Pension Fund (20-1714-0-1-601);

Federal Payments to the Railroad Retirement Accounts (60-0113-0-1-601);

Federal Reserve Bank Reimbursement Fund (20-1884-0-1-803);

Financial Agent Services (20-1802-0-1-803);

Foreign Military Sales Trust Fund (11-8242-0-7-155);

Hazardous Waste Management, Conservation Reserve Program (12-4336-0-3-999);

Health Education Assistance Loans Program Account (75-0340-0-1-552);

Host Nation Support Fund for Relocation (97-8337-0-7-051);

Internal Revenue Collections for Puerto Rico (20-5737-0-2-806);

Intragovernmental funds, including those from which the outlays are derived primarily from resources paid in from other government accounts, except to the extent such funds are augmented by direct appropriations for the fiscal year during which an order is in effect;

Medical Facilities Guarantee and Loan Fund (75-9931-0-3-551);

National Credit Union Administration, Central Liquidity Facility (25-4470-0-3-373);

National Credit Union Administration, Corporate Credit Union Share Guarantee Program (25-4476-0-3-376);

National Credit Union Administration, Credit Union Homeowners Affordability Relief Program (25-4473-0-3-371);

National Credit Union Administration, Credit Union Share Insurance Fund (25-4468-0-3-373);
National Credit Union Administration, Credit Union System Investment Program (25-4474-0-3-376);
National Credit Union Administration, Operating fund (25-4056-0-3-373);
National Credit Union Administration, Share Insurance Fund Corporate Debt Guarantee Program (25-4469-0-3-376);
National Credit Union Administration, U.S. Central Federal Credit Union Capital Program (25-4475-0-3-376);
Office of Thrift Supervision (20-4108-0-3-373);
Operation and Maintenance, Alaska Power Administration (89-0302-0-1-271);
Operation and Maintenance, Southeastern Power Administration (89-0302-0-1-271);
Operation and Maintenance, Southwestern Power Administration (89-0303-0-1-271);
Panama Canal Commission Compensation Fund (16-5155-0-2-602);
Payment of Vietnam and USS Pueblo prisoner-of-war claims within the Salaries and Expenses, Foreign Claims Settlement account (15-0100-0-1-153) ;
Payment to Civil Service Retirement and Disability Fund (24-0200-0-1-805);
Payment to Department of Defense Medicare-Eligible Retiree Health Care Fund (97-0850-0-1-054);
Payment to Judiciary Trust Funds (10-0941-0-1-752);
Payment to Military Retirement Fund (97-0040-0-1-054);
Payment to the Foreign Service Retirement and Disability Fund (19-0540-0-1-153);
Payments to Copyright Owners (03-5175-0-2-376);
Payments to Health Care Trust Funds (75-0580-0-1-571);
Payments to Social Security Trust Funds (28-0404-0-1-651);
Payments to the United States Territories, Fiscal Assistance (14-0418-0-1-806);
Payments to trust funds from excise taxes or other receipts properly creditable to such trust funds;
Payments to widows and heirs of deceased Members of Congress (00-0215-0-1-801);
Postal Service Fund (18-4020-0-3-372);
Reimbursement to Federal Reserve Banks (20-0562-0-1-803);
Salaries of Article III judges;
Soldiers and Airmen's Home, payment of claims (84-8930-0-7-705);
Tennessee Valley Authority Fund, except non-power programs and activities (64-4110-0-3-999);
Tribal and Indian trust accounts within the Department of the Interior which fund prior legal obligations of the Government or which are established pursuant to Acts of Congress regarding Federal management of tribal real property or other fiduciary responsibilities, including but not limited to Tribal Special Fund (14-5265-0-2-452), Tribal Trust Fund (14-8030-0-7-452), Indian Land and Water Claims Settlements (14-2303-0-1-452), White Earth Settlement (14-2204-0-1-452), and Indian Water Rights and Habitat Acquisition (14-5505-0-2-303);
United Mine Workers of America 1992 Benefit Plan (95-8260-0-7-551);
United Mine Workers of America 1993 Benefit Plan (95-8535-0-7-551);
United Mine Workers of America Combined Benefit Fund (95-8295-0-7-551);
United States Enrichment Corporation Fund (95-4054-0-3-271);
Universal Service Fund (27-5183-0-2-376);
Vaccine Injury Compensation (75-0320-0-1-551);
Vaccine Injury Compensation Program Trust Fund (20-8175-0-7-551); and
Western Area Power Administration, Borrowing Authority, Recovery Act (89-4404-0-3-271).

(B) The following Federal retirement and disability accounts and activities shall be exempt from reduction under any order issued under this part:
Black Lung Disability Trust Fund (20-8144-0-7-601);
Central Intelligence Agency Retirement and Disability System Fund (56-3400-0-1-054);
Civil Service Retirement and Disability Fund (24-8135-0-7-602);
Comptrollers general retirement system (05-0107-0-1-801);
Contributions to U.S. Park Police annuity benefits, Other Permanent Appropriations (14-9924-0-2-303);
Court of Appeals for Veterans Claims Retirement Fund (95-8290-0-7-705);
Department of Defense Medicare-Eligible Retiree Health Care Fund (97-5472-0-2-551);
District of Columbia Federal Pension Fund (20-5511-0-2-601);

District of Columbia Judicial Retirement and Survivors Annuity Fund (20-8212-0-7-602);
Energy Employees Occupational Illness Compensation Fund (16-1523-0-1-053);
Foreign National Employees Separation Pay (97-8165-0-7-051);
Foreign Service National Defined Contributions Retirement Fund (19-5497-0-2-602);
Foreign Service National Separation Liability Trust Fund (19-8340-0-7-602);
Foreign Service Retirement and Disability Fund(19-8186-0-7-602);
Government Payment for Annuitants, Employees Health Benefits (24-0206-0-1-551);
Government Payment for Annuitants, Employee Life Insurance (24-0500-0-1-602);
Judicial Officers' Retirement Fund (10-8122-0-7-602);
Judicial Survivors' Annuities Fund (10-8110-0-7-602);
Military Retirement Fund (97-8097-0-7-602);
National Railroad Retirement Investment Trust (60-8118-0-7-601);
National Oceanic and Atmospheric Administration retirement (13-1450-0-1-306);
Pensions for former Presidents (47-0105-0-1-802);
Postal Service Retiree Health Benefits Fund (24-5391-0-2-551);
Rail Industry Pension Fund (60-8011-0-7-601);
Retired Pay, Coast Guard (70-0602-0-1-403);
Retirement Pay and Medical Benefits for Commissioned Officers, Public Health Service (75-0379-0-1-551);
Special Benefits for Disabled Coal Miners (16-0169-0-1-601);
Special Benefits, Federal Employees' Compensation Act (16-1521-0-1-600);
Special Workers Compensation Expenses (16-9971-0-7-601);
Tax Court Judges Survivors Annuity Fund (23-8115-0-7-602);
United States Court of Federal Claims Judges' Retirement Fund (10-8124-0-7-602);
United States Secret Service, DC Annuity (70-0400-0-1-751); and
Voluntary Separation Incentive Fund (97-8335-0-7-051).

(2) Prior legal obligations of the Government in the following budget accounts and activities shall be exempt from any order issued under this part:
Biomass Energy Development (20-0114-0-1-271);
Check Forgery Insurance Fund (20-4109-0-3-803);
Credit liquidating accounts;
Credit reestimates;
Employees Life Insurance Fund (24-8424-0-8-602);
Federal Aviation Administration, Aviation Insurance Revolving Fund (69-4120-0-3-402);
Federal Crop Insurance Corporation fund (12-4085-0-3-351);
Federal Emergency Management Agency, National Flood Insurance Fund (58-4236-0-3-453);
Geothermal resources development fund (89-0206-0-1-271);
Homeowners Assistance Fund (97-4090-0-3-051);
International Trade Administration, Operations and administration (13-1250-0-1-376);
Low-Rent Public Housing—Loans and Other Expenses (86-4098-0-3-604);
Maritime Administration, War Risk Insurance Revolving Fund (69-4302-0-3-403);
Natural Resource Damage Assessment Fund (14-1618-0-1-302);
Overseas Private Investment Corporation, Noncredit Account (71-4184-0-3-151);
Pension Benefit Guaranty Corporation Fund (16-4204-0-3-601);
Rail service assistance within the Safety and Operations account (69-0700-0-1-401);
San Joaquin Restoration Fund (14-5537-0-2-301);
Servicemembers' Group Life Insurance Fund (36-4009-0-3-701); and
Terrorism Insurance Program (20-0123-0-1-376).

(3) Non-budgetary accounts and activities, including the following, are exempt from sequestration under this part:
Credit financing accounts;
Deposit funds;
Federal Reserve;
Government Sponsored Enterprises, including the Federal National Mortgage Association and the Federal Home Loan Mortgage Corporation; and
Thrift Savings Fund.

"(h) LOW-INCOME PROGRAMS.—The following programs shall be exempt from reduction under any order issued under this part:
Academic Competitiveness/Smart Grant Program (91-0205-0-1-502);
Child Care Entitlement to States (75-1550-0-1-609);

Child Enrollment Contingency Fund (75-5551-0-2-551);
Child Nutrition Programs (with the exception of special milk programs) (12-3539-0-1-605);
Children's Health Insurance Fund (75-0515-0-1-551);
Commodity Supplemental Food Program (12-3512-0-1-605);
Contingency Fund (75-1522-0-1-609);
Family Support Programs (75-1501-0-1-551);
Federal Pell Grants under section 401 Title IV of the Higher Education Act;
Grants to States for Low-Income House Projects in Lieu of Low-Income Housing Credit Allocations, Recovery Act (20-0139-0-1-604);
Grants to States for Medicaid (75-0512-0-1-551);
Payments for Foster Care and Permanency (75-1545-0-1-609);
Special Supplemental Nutrition Program for Women, Infants, and Children (WIC) (12-3510-0-1-605);
Supplemental Nutrition Assistance Program (12-3505-0-1-605);
Supplemental Security Income Program (28-0406-0-1-609); and
Temporary Assistance for Needy Families (75-1552-0-1-609).".
(d) Economic Recovery Programs.—Section 255 of BBEDCA is amended by adding the following after subsection (h)——
"(i) ECONOMIC RECOVERY PROGRAMS.—The following programs shall be exempt from reduction under any order issued under this part:
All programs enacted in, or increases in programs provided by, the American Recovery and Reinvestment Act of 2009;
Exchange Stabilization Fund-Money Market Mutual Fund Guaranty Facility (20-4274-0-3-376);
Office of Financial Stability (20-0128-0-1-376);
Financial Stabilization Reserve (20-0131-4-1-376);
GSE Mortgage-Backed Securities Purchase Program Account (20-0126-0-1-371);
GSE Preferred Stock Purchase Agreements (20-0125-0-1-371);
Office of Financial Stability (20-0128-0-1-376);
Special Inspector General for the Troubled Asset Relief Program (20-0133-0-1-376);
Troubled Asset Relief Program Account (20-0132-0-1-376);
Troubled Asset Relief Program Equity Purchase Program (20-0134-0-1-376);
Troubled Asset Relief Program, Home Affordable Modification Program (20-0136-0-1-604).".

Chairman SPRATT. Thank you very much. We look forward for working with you for the passage of this particular bill.

Thank you again, Dr. Orszag.

Now, Douglas Holtz-Eakin and Bob Greenstein.

Earlier, Alice Rivlin was to testify, but, due to the schedule change, she could not make it, but if there is no objection, her testimony will be made part of the record at this point.

[The prepared statement of Alice Rivlin follows:]

PREPARED STATEMENT OF ALICE M. RIVLIN, THE BROOKINGS INSTITUTION AND GEORGETOWN UNIVERSITY

Chairman Spratt and members of the Committee: I am happy to be back before this Committee to support the enactment of statutory PAYGO. Enshrining in law the PAYGO rules which Congress adopted in 2007 would highlight their importance and make them easier to enforce. Statutory PAYGO is a small, but important step toward restoring fiscal discipline to the federal budget. Along with President Obama, the Blue Dog Coalition, and many other proponents of responsible federal budgeting, I urge you to take this step without delay.

THE LONG TERM BUDGET OUTLOOK: IMPENDING CATASTROPHE

No one needs to remind this Committee that the outlook for the federal budget is worrisome—indeed, scary. Long before the financial crisis and the current deep recession, this Committee was anxiously pointing out that current federal spending and revenue policies are on a risky, unsustainable course. Promises made under the major entitlement programs (especially Medicare and Medicaid) will increase federal spending rapidly over the next couple of decades, as the population ages and medical spending continues to rise faster than other spending. Federal expenditures are projected to grow substantially faster than revenues, opening widening deficit gaps that cannot not be financed.

The financial crisis and the recession, combined with the measures the government has taken to mitigate both, have worsened the budget outlook dramatically. The federal deficit will probably reach 13 percent of the GDP this year and will likely remain at worrisome levels even as the economy recovers. Federal debt held by the public, including our foreign creditors, is projected to double as a percent of GDP over the next decade. The recent rise in long term Treasury rates is a timely reminder that our creditors, foreign and domestic, may lose faith in America's willingness to take the difficult steps necessary to move the budget toward balance. This loss of faith—reversing the widespread perception that U.S. Treasuries are the safest securities in the World—could lead to rapidly rising interest rates, killer debt service costs for the federal government and others, a plunging dollar, and an aborted recovery.

As I testified before this Committee on January 27, 2009, I strongly believe that most of the emergency actions that authorities have taken to stimulate the economy and rescue the financial sector were the right policies in these dire circumstances. An escalating deficit and huge amounts of debt were necessary to avoid a much deeper and longer recession and a total meltdown of the financial system. However, these actions have made it absolutely necessary for Congress and the Administration to work together aggressively to bring future deficits under control. Unpopular actions to restrain future spending and augment future revenues must be taken now, even before recovery has been achieved. Putting Social Security on a sound fiscal base, credibly reducing the rate of growth of federal health spending, and raising future energy-related and other revenues are all actions that could be taken now to reduce future deficits.

Immediate actions to reduce long-term deficits—such as fixing Social Security this year—will enhance the prospects for recovery by restoring confidence in government and reducing long-term interest rates. These actions to reduce future deficits will require political courage. Stronger budgetary rules, such as statutory PAYGO, can bolster political courage.

STATUTORY PAYGO: ONE TOOL FOR FISCAL DISCIPLINE

PAYGO is budget speak for "do no harm" or "don't make future deficits worse." PAYGO rules are designed to discourage Congress and the Administration from enacting legislation that would add new mandatory benefits or reduce revenues without taking other actions that would have equal and opposite effects on the deficit over a ten year period. Statutory PAYGO affecting both mandatory spending and taxes was in effect from 1991 through 2002, when the legislation lapsed and was not reenacted. Currently PAYGO is part of the House and Senate rules, but does not have the force of law.

I believe that statutory PAYGO proved a highly effective deterrent to deficit-increasing legislation in the 1990's—at least until the surplus was achieved in 1998. The effects of PAYGO were not visible to the public or the press because they involved spending and taxing proposals that never saw the light of day. At the Office of Management (OMB) in President Clinton's first term my uncomfortable job was to tell the President and rest of the Administration that many of their most cherished ideas could not even be proposed because we could not find a way to off-set them under the PAYGO rules. Similar conversations took place in Congressional committees. Detractors of PAYGO, who point out that a serious sequestration has never been enforced, miss the point that sequestration is a deterrent, not a policy. It would be a more powerful deterrent if it could be waived only by enacting a law subject to veto. I believe sequestration would be an even more effective as a deterrent if there were fewer exceptions to its automatic cuts.

THE DIFFICULT PROBLEM OF DEFINING THE BASELINE

The most difficult decision in designing a strong PAYGO rule is answering the question, "Don't make deficits worse compared to what?" Should the baseline be strictly current law or a more realistic appraisal of what is likely to happen? In general, it is best to stick with current law, because it is the easiest rule to understand and explain. However, occasionally extending currently law is clearly not what most people expect to happen.

President Obama's statutory PAYGO proposal recognizes that four specific provisions of existing law are so unrealistic that incorporating them in a current law baseline would make the PAYGO rule unworkable. The proposal recognizes that Medicare payments to physicians under Part B will not automatically be cut by 21 percent as the law requires; the estate and gift tax will not expire in 2010 and return to pre-2001 levels in 2011; that the current AMT patch will not be allowed to expire without replacement; and that all of the 2001 and 2003 tax provisions will

not all expire at the end of 2010. Critics of the Administration's proposal point out that allowing these adjustments to a current law baseline amounts to accepting the damage already done to future budgets that these bizarre legislative provisions were designed to hide. They argue that in making these exceptions Congress would be ducking the responsibility to face the consequences of its past lack of budgetary courage. I agree that these are four examples of legislative sleight of hand covering up future bad news. But the bad news must be dealt with head-on in a comprehensive policy process. Keeping these four legislative anomalies in the current law baseline for PAYGO purposes, would only guarantee that PAYGO would be immediately waived and its future usefulness seriously impaired.

MOVING BEYOND STATUTORY PAYGO

While I support the Administration's proposal for Statutory PAYGO, I regard it as a small first step on the arduous path that will move the budget to long run sustainability. We also need firm caps on discretionary spending. But the biggest threat to future budget solvency is not new legislation; it is the budgetary consequences of legislative decisions already made—both with respect to mandatory spending and the tax code.

While the current annual budget process involves Herculean efforts to scrutinize discretionary spending, it leaves entitlement programs and revenues on automatic pilot outside the budget process. Fiscal responsibility requires that all long-term spending commitments be subject to periodic review along with taxes and tax expenditures. There is no compelling logic for applying caps and intense annual scrutiny to discretionary spending, while leaving huge spending commitments, such as Medicare or the home mortgage deduction entirely outside the budget process and not subject to review on a regular basis. Nor is there any good reason for subjecting new mandatory spending and revenue legislation to an elaborate PAYGO procedure while ignoring the budget implications of past legislation.

I am a member of a bipartisan group called the Fiscal Seminar (sponsored by The Brookings Institution and the Heritage Foundation) that addressed this problem in a controversial paper entitled, Taking back our Fiscal Future, in 2008. We proposed that Congress enact long run budgets for the three biggest entitlement programs. These budgets would be reviewed every five years. Spending overruns would trigger automatic spending cuts or revenue increases that would take effect unless Congress acted. We recognized that we had proposed only a partial solution—the tax side of the budget should be included—and others may have better ideas. However, we clearly identified a glaring defect in the budget process that stands in the way of getting the federal budget on a sustainable long run track. We believe it is imperative for Congress to adopt a new budget process that includes ALL spending and revenue and subjects the budget impacts of long-term commitments to serious periodic review.

Thank you, Mr. Chairman and members of the Committee.

Chairman SPRATT. Our witnesses are no strangers to us.

Bob Greenstein is the founder and executive director of the Center on Budget and Policy Priorities. He provides testimony, expertise, and assistance to us on a wide range of budget policies; and we are fortunate to have you with us here today.

Douglas Holt-Eakin, we know him well. He served as the sixth Director of CBO, worked with both President Bushes and with the McCain campaign. We are glad to have you with us as well.

STATEMENTS OF DOUGLAS HOLTZ–EAKIN, PH.D., FORMER DIRECTOR, CONGRESSIONAL BUDGET OFFICE AND ROBERT GREENSTEIN, EXECUTIVE DIRECTOR, CENTER ON BUDGET AND POLICY PRIORITIES

Chairman SPRATT. Let us begin with you, Mr. Holtz-Eakin. You have submitted your testimony. We will make it part of the record and you may summarize it as you see fit.

The floor is yours.

STATEMENT OF DOUGLAS HOLTZ–EAKIN

Mr. HOLTZ-EAKIN. Thank you, Mr. Chairman, for the chance to be back at the House Budget Committee, one of my favorite places.

Let me make just a few brief points which have—given the conversation thus far—won't be terribly original.

Point number one is that this discussion begins with a budgetary outlook that is quite bleak. The President's budget, as priced by CBO, shows very large deficits which get only as low as 3.9 percent of GDP over the next 10 years. They are above that and rising towards the end of the budget window. The net effect of that is debt in the hands of the public as a fraction of GDP again doubles from 40 to 82 percent and is rising at the end of that window; and we find ourselves in the position on this trajectory that the United States is borrowing large amounts of money, two-thirds of which is used simply to pay the interest on debt.

So this is a situation which, taken at face value, is alarming, to say the least. And, at least to my eye, it is an optimistic outlook, because there are many assumptions in the President's budget which I don't see as likely to come to pass; and they are in my written testimony. But the revenues from cap-and-trade auction of permits doesn't look to be likely to arrive on the schedule that is assumed in the budget; and some of the tax proposals may not materialize.

The upshot of that is from a perspective of the actions that are presumed to be in there, everything is a risk toward even larger deficits, additional debt, and that poses to this Nation a very serious economic threat.

So, in light of that, I welcome the notion that the administration is interested in statutory measures that would stop the decay in our fiscal situation and maybe even improve it, and I believe the legislation that they submitted for the Congress represents such a step, and it should be applauded for that. But it is, at best, a modest step in the right direction and for the reasons that have been noted earlier.

This PAYGO proposal does not constitute a broad-based, comprehensive budget enforcement approach. Multi-year discretionary spending caps are not present, as everyone has noted; and the absence of a comprehensive approach does lead to the possibility of gaming the PAYGO proposals in a way that limits their effectiveness.

For example, at least as I read the legislation, it does appear possible to create programs on the discretionary side, convert them to mandatory programs and evade this entirely. And that is troubling if one wants to limit the growth in spending which, in the end, is the ultimate threat to the Federal budget.

So I think a stronger proposal would be one that was more comprehensive, did focus on spending and getting it under control and put us moving in the right direction.

The second, as has been discussed extensively, is the notion that we would exclude these large policies, sustainable growth rate mechanisms, tax policy from 2001, 2003, from the PAYGO rules. And this does a couple of things.

Number one, those will increase deficits. I mean, there is no way around it. There will be large, significant impact on the deficit by

excluding them. So you can't pretend that you haven't incurred that.

The second is it creates an unlevel playing field. Those policies are preferred under these rules to other policies, and it is not obvious to me why a Congress would adopt a set of rules that would prefer some policies over others. The idea should be that we have a level playing field, a policy debate, and an enforcement mechanism to make sure those policies don't damage the fiscal situation.

That is one of the ways in which these proposals would actually change the balance between Congress and the administration. The administration's policies get preferential treatment. The administration does the scoring, as a matter of necessity, under this proposal; and the Congress should recognize that that is part of what goes on in these proposals.

The other thing that jumps out is that they strike me as unnecessarily complex for what they accomplish. I think the 10-year averaging, unlike the previous version of PAYGO that we saw, raises more problems than it solves. It would be entirely possible to squeeze the Medicare sustainable growth rate procedures right through this 10-year averaging. Every year, you could give the docs a big update, promise to cut it 37 percent in the outyears. The 10-year average would be zero. You could repeat this charade year after year. So that doesn't strike me as improvement.

That is a problem, and I would encourage you to revisit that in anything you pass through the Congress.

And, in closing, I think it is important to recognize that rules such as PAYGO are no substitute for the genuine political will to solve the problem that we can see before us in any budgetary presentation. And it is unlikely, I think, that these rules will be in place for the legislation on health care reform that both Houses of Congress will contemplate this year and so that we will see in that discussion whether the Congress understands the gravity of the problem that faces us.

The very best-case scenario is that legislation will not worsen an already bleak fiscal picture. That is the best thing that could happen. And I find that a troubling best-case scenario. The possibility that the Congress would choose to do less than the best and actually make this worse while ostensibly reforming the health care system is something I think we ought to keep our eye out for.

I thank you for the chance to appear today, and I look forward to your questions.

[The prepared statement of Douglas Holtz-Eakin follows:]

PREPARED STATEMENT OF DOUGLAS HOLTZ-EAKIN, FORMER DIRECTOR, CONGRESSIONAL BUDGET OFFICE

Chairman Spratt, Ranking Member Ryan, and Members of the Committee, thank you for the opportunity to discuss the outlook for the U.S. federal budget and, in particular, the Administration's PAYGO proposals. I wish to make three primary points:

- The budgetary outlook for the federal government is bleak, the policy risks are that it will worsen, and a failure to address the deficits and rising debt are a danger to the Nation's economic outlook.
- The Administration's PAYGO proposals are a modest step, at best, toward this objective. Stronger budgetary controls would be more comprehensive in scope and focused on controlling federal spending.
- PAYGO procedures are not a substitute for the political will to undertake fiscally-responsible policy proposals. The health care reform debate will be a test of

whether Congress and the Administration are serious about addressing the budgetary outlook.

I discuss these in more detail below.

THE BUDGET OUTLOOK

The federal budget outlook is bleak. As estimated by the Congressional Budget Office, under the President's Budget proposals, the federal deficits exceeds $600 billion every year from 2010 to 2019, falls only as low as 3.9 percent of Gross Domestic Product (GDP) in 2013, and is rising both in absolute value and as a fraction of GDP toward the end of the budget window. As a result, debt in the hands of the public is estimated to be 82 percent of GDP in 2019—up from 41 percent in 2008—and rising. In 2019, net interest costs are essentially $800 billion, over two-thirds of the overall deficit.

The bottom line is clear: these policies place the U.S. on a path of dangerously large deficits, spiraling debt burdens, and borrowing dominated by the need to pay interest costs on previous borrowing.

On balance, I think this is an optimistic assessment of the outlook as the budget has large political and economic risks. To begin, the expected climate auction revenues are unlikely to materialize. There has never been a climate bill that auctioned a significant fraction of the permits. There has never been a climate bill that passed the Senate. There has never been a climate bill that has been voted on the floor in the House. In short, there has to be an incredible shift in the history for this to happen in a timely enough fashion to get the anticipated revenues that exceed $600 billion. Evidence from the House debate further solidifies the assessment that the odds are that it won't happen and the deficit will be higher.

In the same way, many of the Administration's tax hikes on individuals and businesses are politically difficult and economically undesirable. The business community has correctly pointed out the anti-competitive impacts of moving away from the ability to defer taxes on foreign-source income. Higher marginal tax rates will impact productive Americans and small businesses. If the economy is not strong in 2011, will it be a good idea to hit it with a massive tax hike? In short, these revenue increases are risky.

In contrast, the tax credits and spending that these revenues are planned to pay for are already on the books courtesy of the "stimulus" bill. A reasonable reading of the outlook is that all the revenue will not show up, all the spending and transfers will not go away, and deficits will be even higher than CBO estimates.

In addition, interest rates could easily exceed the projected levels, adding an economic risk to the policy risks. As debt continues to pile up, U.S. international creditors will impose unpleasant terms and a potentially-struggling economy will be further burdened.

THE ADMINISTRATION'S PAYGO PROPOSAL

In light of the budgetary outlook, it is encouraging that the Administration has put forward proposed statutory changes to impose PAYGO rules on the budget process. At the same time, the proposals are far from a comprehensive framework for budgetary enforcement, contain too many "loopholes", are needlessly complex, and ultimately are not likely to contribute significantly to improving the fiscal outlook.

The first observation is that the PAYGO proposals fall short of a comprehensive framework for budget enforcement. In particular, they are not accompanied by complementary proposals for discretionary spending such as multi-year spending caps. In their absence, there will be an unavoidable temptation to migrate proposals to the appropriations process. The Administration's proposals do recognize this incentive and attempt to mitigate it. However, my reading of the language suggests it remains possible to start initiatives as discretionary programs, convert them to mandatory spending after several years, and avoid PAYGO constraints.

A more comprehensive approach would be desirable. And any such budget enforcement initiative would be well-served to focus on the outlay side. As successive publications of the CBO's Long Term Budget Outlook have made clear, the long-run fiscal policy problem is a spending problem; it is not reasonable to expect to "grow our way" out of the problem or economically feasible to "tax our way" out of it. Setting in place comprehensive budgetary controls to limit spending growth should be the top enforcement priority.

A second issue with the Administration's proposals is the exemptions for particular policies such as fixes to the Alternative Minimum Tax, updates to physicians' payments in Medicare baseline policies, extension of the tax policies enacted in 2001 and 2003, and (apparently) the resources to fund Fannie Mae and Freddie Mac. Spending is spending, tax cuts are tax cuts, and deficits are deficits. Any PAYGO

should provide a level playing field among such initiatives and these proposals do not.

In effect, the Administrations proposals tilt the playing field toward their preferred policies. In this regard, it is worth noting that the operation of the PAYGO procedures potentially raise the power of the Administration relative to Congress, as the Office of Management and Budget would have the only say over the scorekeeping related to operation of the proposals.

In addition to the favored treatment of particular policy initiatives, the proposals exempt large amounts of spending from the potential for sequester. This has a twofold effect on the operation of the enforcement. First, it becomes unlikely that a substantial sequester will be tolerated on such a narrow budgetary base, thereby undermining the very discipline that PAYGO is intended to introduce. Second, because the procedures will be most effective in negative "small" violations, it begs the question as to whether these proposals represent a significant enough advance over the existing rules in both the House and Senate budget procedures.

Finally, the procedures appear to be needlessly complex. In previous implementations of PAYGO, it was necessary to offset any deficit increases as they occurred in each budget year, or else face a sequester in that year. These proposals require the average deficit increase over the next 10 years to entered into the budget year and, thus, trigger a potential sequester. This appears to permit nothing to be offset up front. Why is this a better system, given that it is both more complicated and less stringent?

FISCAL DISCIPLINE

Fiscal discipline will not take the form of new rules for the budget process. Instead, it must be a collective political effort. There is a lot of talk about the need for bipartisanship in Washington, and I think fiscal responsibility would be a good place to start. And there is no greater opportunity than in proposals to reform the health care system.

Health care reform is one of the most important issues facing the United States is its underperforming health care sector. There are three major problems. First, it costs too much. For the past three decades health care spending per person has grown roughly 2 percentage points faster every year than income per capita. That is, in the horse race between costs and resources, costs have been winning. The result is that health care spending right now exceeds 17 cents of every national dollar—and will rise to 20 percent by the end of next decade. Within the federal budget, the rising cost of Medicare and Medicaid threatens a tsunami of red ink in the decades to come.

Second, because health care is getting more expensive, the cost of health insurance is skyrocketing. Over the last decade, insurance costs have increased by 120 percent—three times the growth of inflation and four times the growth of wages. With higher costs has come reduce insurance coverage—more than 45 million are uninsured. It is important to solve the first problem—rising costs—before committing to large-scale coverage expansions. Doing them in the wrong order will be prohibitively expensive, and likely cause the reform effort to unwind.

Finally, both the health insurance and health care systems under-perform. A job loss typically also means loss of health insurance. High spending has not yielded comparably high outcomes for infant mortality, longevity, or treatment of chronic disease.

Health care reform can address these issues. However, it will not automatically be consistent with budgetary objectives. It seems likely that mandatory health care legislation addressing reform will be considered before any PAYGO legislation is put in place. One will not be able to count on its provisions to constrain the budgetary impact of health care reform. Instead, the Congress must make a commitment to impose this on the legislation.

This suggests that the first principle should be to focus on the value provided by care. Any reform that does not address low-value care and cost growth will fail. Suppose, for example, that the "reform" consisted of a mandate to purchase insurance, thereby achieving "universal" health insurance. In the absence of changes to the growth in health-care spending, this insurance would become increasingly expensive and ultimately force families to evade the mandate as a matter of economic necessity. At the same time, those dollars that were devoted to health care would purchase care that was of no greater overall effectiveness than at present. In short, the reform would fail to address the policy problems.

Fiscal responsibility also suggests that it would be unwise to move immediately to universal coverage or other massive expansion. Reforms to the delivery system could generate system-wide savings that could be funneled to expanding coverage,

and opportunities within government programs could generate savings as well. But it is implausible that these savings would be sufficient for an immediate, large-scale coverage expansion costing over $1 trillion. Instead, the fiscally-responsible reform should be a process that leads to increasing insurance.

I believe that a fiscally responsible and durable reform is more likely if it is genuinely bipartisan enterprise. Any other path will likely lead to even larger budget pressures; perhaps so large that it undercuts the momentum of health reform itself and opens the economy to the risk of higher interest rates and pressures from international capital markets.

Chairman SPRATT. Bob Greenstein.

STATEMENT OF ROBERT GREENSTEIN

Mr. GREENSTEIN. Mr. Chairman, Congressman Ryan, and members of the committee. I appreciate the opportunity to explain why I think pay-as-you-go discipline is very important and enactment of a statutory pay-as-you-go rule would be beneficial. I would like to make five points.

First, as you know, the U.S. faces a serious long-term fiscal problem that we need to address. But without changes in policies we face the prospect of rapidly growing Federal deficits and debt over time that in the long run will pose a threat to the U.S. economy, to the standard of living of Americans, and to the ability of the government to meet the needs of its citizens.

Second, I would note that this proposal represents a significant break from the past. The last administration pushed deficit financing of nearly all of its major initiatives, including the 2001 and 2003 tax cuts and the 2004 prescription drug legislation. In contrast with this proposal, the Obama administration is proposing to bar deficit financing for its own top initiatives like health care reform, even though that may make the initiatives harder to push through Congress. Proponents of fiscal responsibility should applaud that commitment.

Third, while a well-designed pay-as-you-go rule can make a real contribution to fiscal discipline, it will have little effect if there is no real commitment on the part of Congress to abide by it. That is why we think criticism of the President's proposal to exempt the cost of extending certain specified policies that are scheduled to expire is misguided.

To be sure, it would be highly desirable to pay for any extensions of expiring current policies. But it has become quite clear that there is no chance the tax cuts enacted in 2001 and 2003 that benefits the middle-class provisions enacted to limit the scope of the estate tax, relief to prevent the alternative minimum tax from hitting tens of millions of middle-class families and the deferral of a requirement to cut Medicare physician payments by 21 percent, there is no chance that they will be allowed to expire or be paid for.

Doesn't make any sense to put in place a pay-as-you-go rule that says these extensions must be paid for when everyone knows that they won't be. Rather than making a phony promise that will inevitably lead to a series of waivers of the pay-as-you-go statute, waivers that would undermine support for the rule itself and open the door to wholesale waivers for other costly new policies, rather than doing that, it is better to acknowledge up front that these specified extensions of current law will not be subject to the rule and insist that the rule be strictly applied to any other legislation that is not

paid for. As a result, I believe these exceptions actually strengthen the fiscal discipline aspects of the rule.

And I would note that this aspect of the proposal parallels the treatment in this year's budget resolution with respect to House enforcement of its own pay-as-you-go rule.

Fourth, I would note that the pay-as-you-go rule proved very successful in the 1990s, an experience that demonstrates the vacuity of claims that pay-as-you-go is some gimmick with no real effect.

For a good part of the 1990s, Congress and the President paid for virtually all increases and mandatory programs and tax cuts, including even paying for the extension of the measures known as the tax extenders. Pay-as-you-go contributed to achieving the first Federal budget surpluses in 30 years.

Fifth and finally, having made the first four points, I do want to emphasize that abiding by the pay-as-you-go rule will certainly not be sufficient by itself to address the Nation's long-term fiscal problems. Budget rules such as PAYGO can be important. The actual policy decisions, including those made in coming months on issues like health care, will be even more important in demonstrating a real commitment to begin dealing with the problem.

The decisions that will be made on health care reform are crucial. I believe it is essential for Congress and the President to demonstrate a commitment to the PAYGO principle by fully paying for the cost of health care reform over the next 10 years, and it is also crucial that health care reform be designed to produce changes in our health system that begin the steps of the slowing of the growth of health care costs systemwide, both the public and private sectors, without which we will never be able to assure sustainability of the Federal budget.

Let me close by saying that a failure to deal with the long-term fiscal problem will have deleterious consequences. Eventually, the run-up in debt would harm the economy and the standard of living of Americans. It is also possible that even before the debt rises to such levels failures to address the problem would leave credit markets around the world to decide that continuing to lend large amounts to the U.S. to finance its deficits isn't desirable, pushing up interest rates and potentially triggering a financial crisis that could cost millions of U.S. jobs.

It is also clear that spiraling deficits and efforts to deal with them in a crisis atmosphere could threaten crucial Federal programs that provide assistance to the Nation's most vulnerable citizens as well as to veterans, students seeking a college education, and many others. I need only cite what is going on in the crisis atmosphere in the State of California right now as an example. In that circumstance, rather than being addressed, vital unmet needs would grow.

The bottom line is that virtually no one in this country would go unharmed if we simply keep kicking the can down the road and putting off for years to come beginning to address the long-term fiscal problem.

Thank you.

[The prepared statement of Robert Greenstein follows:]

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

Mr. Chairman, Congressman Ryan, and members of the Committee, I appreciate the opportunity to appear here today to explain why I think pay-as-you-go discipline is important, why enactment of a statutory pay-as-you-go rule to reinforce Congressional rules can be beneficial, and why enactment of a statutory pay-as-you-go rule is not itself sufficient to achieve fiscal sustainability.

To explain my view of the benefits and limits of a pay-as-you-go rule, I would like to make three points:

- The United States faces a serious long-term fiscal problem that must be addressed. The current high deficits levels are unfortunate, although it would not be sensible to try to reduce them while the economy remains weak. Deficits are then expected to decline over the next few years as the economy improves. But without changes in current policies, we face the prospect of rapidly growing federal deficits and debt over time that will pose a significant threat to the U.S. economy, to the standard of living of all Americans, and to the ability of the government to meet the needs of its citizens.
- A well-designed pay-as-you-go rule can make a real contribution to the fiscal discipline needed to address the long-term fiscal problem, if there is a real commitment to abiding by the principle that any new tax cuts or mandatory program increases must be paid for. Putting the pay-as-you-go rule in statute does not guarantee that Congress and the President will comply with the rule. Just as is the case with House and Senate rules, a statutory PAYGO rule can be waived if there is sufficient support in the Congress for tax cuts or entitlement increases that are not paid for and the President does not veto legislation that violates the rule. But a statutory pay-as-you-go rule can increase the likelihood the pay-as-you-go principle will be followed. Some lawmakers may be more hesitant to support a waiver of a statutory rule they have supported. In addition, it would be harder for a future Congress to simply eliminate a rule that has been written into statute. Finally, the process of enacting such a rule may help create and demonstrate commitment to the principle behind the rule.

As noted, the statutory rule will have little effect if there is no real commitment to living by it. That is why we think criticism of the President's proposal to exempt the cost of extending specified current policies that are scheduled to expire under current law is misguided. To be sure, the Center on Budget and Policy Priorities believes that in light of the long-term fiscal problem we face, it would be highly desirable to pay for any extensions of expiring current policies. But, it has become absolutely clear that there is no chance that tax cuts enacted in 2001 and 2003 that benefit the middle class, provisions enacted in 2001 that limit the scope of the estate tax, relief to prevent the alternative minimum tax from hitting tens of millions of middle-class families, and the deferral of the requirement to cut Medicare physician reimbursement payments by 21 percent starting next January (which could cause a major exodus of physicians from the Medicare program) will either be allowed to expire or be paid for. It makes no sense to put in place a pay-as-you-go rule that says these extensions must be paid for when everyone knows they will not be. Rather than making a phony promise that will lead inevitably to a series of waivers of the pay-as-you-go statute—waivers that will undermine support for the rule itself and open the door to waivers for other costly policies—it is appropriate to acknowledge up front that these specified extensions of current policy will not be subject to the rule and to insist that the rule be strictly applied to any other legislation that is not paid for. I should note that this is exactly the approach followed in this year's budget resolution with respect to House enforcement of its pay-as-you-go rule,.

- Abiding by the pay-as-you-go principle will not itself be sufficient to deal with the long-term fiscal problem. To put the budget on a sustainable basis it will be necessary to increase revenues above the level produced under current policies (and under President Obama's budget proposals) and to reduce the growth of spending—especially health care spending—below what is currently anticipated.

Before exploring these points in more detail, I would like to make a plea. While budget rules, such as the pay-as-you-go rule, can be important, actual policy decisions that will be made in the next few months will be far more important in demonstrating a real commitment to begin dealing with the long-term fiscal problem. In particular, the decisions that are made about health reform will be crucial. Whether a statutory pay-as-you-go rule is enacted or not, it is essential for the Congress and the President to demonstrate a commitment to the pay-as-you-go principle by fully paying for the cost of health care reform over the next 10 years. That will require some painful steps, such as adopting politically unpopular changes both in

tax laws and in payments to health care providers. But if Congress and the President do not demonstrate that they are willing to take such steps to keep from making an already unsustainable fiscal situation worse, the enactment of a statutory pay-as-you-go rule will ring hollow and will not persuade anyone (including financial markets) that policymakers are willing to deal in a real way with the problems we face. In addition, it is absolutely crucial that the health reform that is enacted produces changes in our health system that begin taking the steps necessary to slow the growth of health care costs systemwide (i.e., in both the public and private sectors). We will never be able to ensure sustainability of the federal budget—or the health of the economy—unless we bring down the growth rate of those costs.

LONG-TERM FISCAL PROBLEM

Projecting federal spending and revenues for coming years, much less for coming decades, is an inexact science and subject to great uncertainty. Nevertheless, there is virtual consensus among budget analysts that current fiscal policies are not sustainable. (Economists generally define a sustainable fiscal path as one in which debt held by the public does not steadily increase as a share of the nation's gross domestic product.). While the precise estimates have differed according to the specific assumptions made, the Congressional Budget Office, the Government Accountability Office, the Office of Management and Budget in both Republican and Democratic administrations, and the Center on Budget and Policy Priorities have all conducted analyses which find that, unless current policies are changed, federal deficits and the debt held by the public will grow steadily in coming decades, relative to the size of the economy, and reach levels far in excess of those previously experienced in the United States or that are safe for the economy.[1]

For example, in the Center's most recent study of the long-term fiscal problem, published last December, we projected that if current policies remain unchanged—assuming for example, that the middle-class tax cuts enacted in 2001 and 2003 are extended beyond 2010 and AMT relief is continued—deficits will grow to levels far in excess of this year's unusually large deficit (likely to total 13 percent of GDP), which is swollen by the deepest recession since World War II. We project that by 2050, the deficit will total 21 percent of GDP with the economy operating at full capacity. Moreover, by that year, the federal debt held by the public would total 280 percent of GDP, far in excess of the record-high 109 percent of GDP reached at the end of World War II.[2] The increase in deficits relative to the size of the economy under current policies is driven by a decline in revenues as a share of GDP (to 17.2 percent of GDP by 2050) and a big increase in the cost of Medicare, Medicaid, and Social Security (from 8.5 percent of GDP last year to 18.9 percent in 2050). (It's worth noting that other programs do not contribute to the growth in deficits as a share of GDP. All mandatory programs other than Social Security, Medicare, and Medicaid are projected to shrink relative to GDP both over the next 10 years and in the decades that follow. In addition, both defense and non-defense discretionary spending have generally fallen as a share of GDP over the last 25 years and are projected to continue to do so.)

The increase in the cost of the "big three" programs—Medicare, Medicaid, and Social Security—is partly due to demographic changes; with the aging of the baby-boom population, an increasing share of the population will be elderly. But the growth of Medicare and Medicaid is much greater than the growth of Social Security, and the primary reason for the growth in those two programs is the growing cost of providing health care per person. (CBO has estimated that more than three-quarters of the projected growth of Medicare and Medicaid through 2050 is due to rising per person health care costs.) It is important to note that the anticipated ris-

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[1] See "The Long-Term Fiscal Outlook is Bleak: Restoring Fiscal Sustainability Will Require Major Changes to Programs, Revenues, and Nation's Health Care System," Richard Kogan, Kris Cox, and James Horney, Center on Budget and Policy Priorities, December 16, 2008; "The Long-Term Budget Outlook," Congressional Budget Office, December 2007; "The Nation's Long-Term Fiscal Outlook: March 2009 Update," United States Government Accountability Office, March 2009; "Part III—The Long-Run Budget Outlook," in Chapter 13 of the "Analytical Perspectives" volume of the Budget of the U.S. Government: Fiscal Year 2010 and the Budget of the U.S. Government: Fiscal Year 2009.

[2] Because these projections were made last December, they do not take into account the full effects of the economic downturn that are apparent now or the cost of the American Recovery and Reinvestment Act (ARRA) enacted this year to help stimulate the economy. Because these effects are temporary, however, they have a much smaller effect on the long-term fiscal problem than many people assume. For instance, the Center on Budget has estimated that roughly $800 billion in stimulus costs would increase the size of the long-term problem by only 3 percent. See, "Economic Recovery Bill Would Add Little to Long-Run Fiscal Problem," Kris Cox and Paul N. Van de Water, Center on Budget and Policy Priorities, January 16, 2009.

ing per-person cost of providing health care through Medicare and Medicaid reflects the anticipated cost of providing care system wide. Medicare and Medicaid costs per person have essentially followed the path of system-wide costs—private as well as public—for more than 30 years and are expected to do so in the future under current policies.

It also may be noted that since entitlements other than the "big three" are actually declining as a share of GDP and are projected to continue doing so for as far as the eye can see, we do not face a general entitlement problem. The causes of our long-term fiscal problem are, essentially, rapidly-rising health care costs system-wide, an aging population, and an inadequate revenue base.

Other projections differ somewhat from ours—some have higher deficits and debt, some have lower. But virtually all agree that deficits and debt will grow to levels that will pose a real threat to the economic health of the United States and the well-being of its citizens. It is clear that this long-term problem must be addressed.

PAY-AS-YOU-GO IN THE 1990S

A pay-as-you-go rule was first established in the Budget Enforcement Act (BEA), which was part of the 1990 deficit reduction agreement negotiated by President George H.W. Bush and Congressional Democrats and Republicans. It is important to remember that the enforcement procedures were a secondary part of that deal—the most important part of the deal was a package of specific changes in law that increased revenues and cut mandatory program spending. Those legislative changes, along with an enforceable agreement to limit future discretionary appropriations, reduced deficits by an estimated $500 billion below the levels projected under then-current policies over five years.

The pay-as-you-go rule was intended to lock in the savings achieved through the tax increases and mandatory cuts by requiring that any subsequent legislation that undid any of those tax or spending provisions, or otherwise cut taxes or increased mandatory spending, had to be paid for with offsetting tax increases or budget cuts. (The BEA also established statutory caps on discretionary appropriations to enforce the agreement to limit that spending.) Specifically, the pay-as-you-go rule required the Office of Management and Budget to determine at the end of a session of Congress whether all of the tax and mandatory spending legislation (other than legislation designated as emergency legislation) enacted during that session had the net effect of increasing the deficit in the current fiscal year (and the fiscal year most recently ended if the legislation had any effect in that year). If OMB estimated that the deficit had been increased, the BEA required implementation of automatic cuts—called sequestration—in spending for mandatory programs that were not specifically exempt (generally, exempt programs were programs meeting the needs of low-income Americans, Social Security, and programs in which the government has a contractual requirement to make payments, such as interest on the federal debt). The Senate also adopted a pay-as-you-go rule aimed at prohibiting consideration of tax and entitlement legislation that would increase the deficit.

The pay-as-you-go approach proved very successful in the 1990s (an experience that demonstrates the vacuity of claims that pay-as-you-go is a gimmick with no real effect). Congress and the President paid for any increases in mandatory programs and any tax cuts, including the extension of expiring measures such as "tax extenders."[3] Along with the effects of the deficit reduction packages enacted in 1990 and 1993 and a vibrant economy (which was likely helped by the federal government's commitment to fiscal discipline), the pay-as-you-go rule helped achieve the first federal budget surpluses in 30 years. At the end of that decade, however, the broad consensus on the importance of abiding by the pay-as-you-go rule broke down in the face of federal budget surpluses, and Congress and the President began enacting waivers that allowed spending increases and tax cuts without offsets. In 2001, in particular, large tax cuts were enacted that were not paid for. The statutory pay-as-you-go rule then was allowed to expire at the end of 2002. A Senate pay-as-you-go rule remained in effect, but was modified in a way that allowed consideration of legislation that increased the deficit so long as the deficit increase had been assumed in the budget resolution, which made the rule rather ineffectual.

[3] During the 1990s, every mandatory increase and tax cut was paid for except for one emergency spending measure. In the face of lingering high unemployment 1993, a final six-month extension of extended unemployment benefits enacted in the 1990-1991 recession was declared an emergency by both the Congress and the President and for that reason was not subject to the pay-as-you-go statute.

PAY-AS-YOU-GO NOW

At the beginning of the 110th Congress, the House adopted a new pay-as-you-go rule to limit House consideration of tax and entitlement legislation that would increase the deficit, and the Senate reinstated a version of the pay-as-you-go rule that had been in effect in the Senate in the 1990s. These rules have had significant effect in deterring enactment of new tax and entitlement policies that would increase the deficit.[4] Those who doubt this deterrent effect have not been involved in the numerous difficult discussions that have occurred with lawmakers and their staffs over how to pay for proposed increases in entitlement benefits or tax cuts and have not seriously considered what would have happened in the absence of the rules.

There have been exceptions to the rule, however. The House and Senate enacted substantial tax cuts and entitlement increases as part of legislation aimed at stimulating the sagging economy and shoring up the nation's financial system without offsetting the costs of those provisions. This was entirely appropriate. The original statutory pay-as-you-go rule, the current House and Senate rules, and the President's proposed statutory rule all provide exceptions for emergency legislation. Legislation needed to deal with a near meltdown of the financial system and the worst economic downturn since the Great Depression certainly qualifies as emergency legislation. Not only would abiding by a requirement to find offsets for these efforts have greatly complicated and delayed enactment of this crucial legislation, placing the economy and financial markets at risk, but it also would have undermined the goal of stimulating the economy during a recession. With severely lagging consumer purchases, business cutbacks in employment and investment, state and local government reductions in employment and purchases of goods and services, and short-term interest rates near zero, a deficit-financed increase in federal spending (for direct purchases of goods and services, transfers to individuals who would increase their purchases, and relief for state and local governments to reduce the cutbacks they are making) and a reduction in federal taxes were the best, if not only, hope of boosting aggregate demand, braking the spiral of cutbacks and layoffs, and keeping an already dire situation from reaching tragic proportions. If the stimulus legislation had raised other taxes or cut other spending to offset the cost of the tax cuts and increased spending provided in the legislation, there would have been no net increase in the aggregate demand for goods and services and no boost to the economy. Any sensible pay-as-you-go rule should allow for an emergency exception for circumstances such as those we have recently faced.

The other notable exceptions cannot be defended on such policy grounds, but they illustrate the political reality that any statutory pay-as-you-go rule needs to take into account. Congress—particularly the Senate—has demonstrated an unwillingness to offset the cost of extending several current policies such as relief from the alternative minimum tax and the deferral of the large reductions in Medicare physician reimbursements required under the so-call sustainable growth rate (SGR) rules. The budget resolution adopted this year also makes clear that the cost of extending the expiring reductions in middle-class taxes and the estate tax enacted in 2001 and 2003 will not be offset. Given the long-term fiscal problem the nation is facing, and the inevitable need for higher revenues and slower spending in coming decades, I believe it is unwise to extend any expiring tax cuts or relief from required reductions in spending without offsetting the cost of those extensions, and I wish that enactment of a pay-as-you-go rule would ensure that they would be paid for. But, it is clear that the majority of lawmakers do not believe these extensions should be paid for and that, regardless of whether a statutory pay-as-you-go rule is enacted that applies to those extensions, Congress will not let those provisions expire or offset the cost of extending them.

Given that basic political reality, it is appropriate that the pay-as-you go rule make an exception for the cost of extending the specified policies. That is what the President's proposal would do, and what the language in this year's budget resolution that governs application of the House pay-as-you-go rule did.

I believe these exceptions strengthen the rule. If there are no such exceptions, there is no doubt that Congress will vote to waive the application of pay-as-you-go when legislation extending those policies is considered. I fear that those waivers will undercut support for the pay-as-you-go rule itself—that having voted to waive the rule a number of times for these extensions, Congress is more likely to vote to waive the rule for other tax cuts or entitlement increases. For example, it is absolutely clear that Congress will not let the estate tax exemption level and tax rates revert

[4] See "The House Has Complied This Year with Its New 'Pay-as-you-go' Rule: But Greater Challenges Lie Ahead," Richard Kogan and James Horney, Center on Budget and Policy Priorities, November 7, 2007.

to the levels set in law prior to 2001. It also is clear that Congress will not pay for the cost of extending the estate-tax exemption and tax rate at the levels currently in effect and, unfortunately, that there is considerable support in the Senate for further increasing the exemption level and further reducing the tax rate without paying for the billions of dollars of additional revenue losses that would generate. If the pay-as-you-go rule is designed so that it applies even to the cost of extending the current estate-tax parameters, then the rule will unquestionably be waived. And if the Senate Finance Committee already must secure a waiver just to bring legislation to the Senate floor that simply extends current estate-tax policies, no additional waiver will be needed for a Finance Committee bill that goes considerably beyond that and further increases the exemption amount and reduces the tax rate without offsetting the cost.

To be sure, it is not certain that it will be possible to hold the line at extension of the current estate-tax policies in any case (or to pay for any costs of further weakening the estate tax). But there will be a much greater chance of doing so if the line in the sand is clearly drawn at extending current policies. The principle should be clear—if Congress extends current policies there will be no need to waive pay-as-you-go, but any attempt to go beyond extension of current policies without offsetting the cost—i.e., to engage in new deficit financing—will require a vote to waive the PAYGO rule that lawmakers have pledged to support.

A number of critics of the President's proposal to except the cost of extensions of current policies from the pay-as-you-go rule have made their point by analogy, comparing the proposal, for instance, to a promise to abide by a diet that excludes chocolate cake or other highly caloric desserts from dietary restrictions. Such analogies are clever, but inaccurate; they miss the mark. A more apt analogy is with a promise to limit caloric intake in order to lose weight. If a person promises to eat nothing for 30 days, the promise is meaningless and clearly will not help achieve the desired outcome. The person will violate the promise every day, and after the person takes the first bite each day there is no useful yardstick to encourage the dieter to stop eating before he or she is satiated. If, however, the person sets a daily caloric intake at a reasonable level, the pledge might actually help the dieter stop overeating. It is true that the promised diet would be meaningless if the caloric intake is set at such a high level that the dieter can eat virtually anything he or she would like without exceeding the limit. But anyone who thinks the Congressional appetite for tax cuts and entitlement increases would be satisfied once Congress extends the expiring policies has not been paying attention. Drawing a line at extending current policies thus should help significantly in promoting fiscal responsibility.

It is important to be clear that simply putting the pay-as-you-go rule in statutory form and enforcing it with an automatic sequestration does not by itself substantially increase the effectiveness of the rule beyond what the House and Senate rules have already accomplished. The House rule can be waived if the Rules Committee recommends such a waiver and a majority of the House then votes for the resolution (or "rule") the Rules Committee has reported. The Senate rule can be waived with a 3⁄5 vote of the Senate. It is true that in order to waive a statutory pay-as-you-go requirement, Congress would have to include a specific waiver in legislation and that the President could veto the legislation containing the waiver if he objects to the violation of the pay-as-you-go rule. But the President already can veto any legislation that violates the pay-as-you-go principle if he objects to the violation.

Nonetheless, I believe that enacting a statutory pay-as-you-go rule to reinforce the current House and Senate rules would be useful. It seems likely that at least some lawmakers would be more reluctant to support an effort to override a statutory pay-as-you-go requirement than to vote for a waiver of House and Senate rules. It also would be more difficult for a new Congress to simply eliminate a statutory rule. Finally, the very process of enacting a statutory pay-as-you-go rule could help build support for and commitment to the pay-as-you-go principle. And that commitment is the key to success of any pay-as-you-go rule. Just as no diet will succeed in getting a person to eat less if he or she is not committed to losing weight, no budget process rule can force Congress and the President to forgo deficit-increasing legislation if they are not committed to bringing deficits under control. And, just as a sensible and realistic diet can help a committed individual lose weight, so can a sensible and realistic pay-as-you-go rule help Congress and President adhere to a commitment to stop digging the deficit hole deeper.

PAY-AS-YOU-GO IS NOT SUFFICIENT

Abiding by the pay-as-you-go principle and avoiding making the long-term fiscal problem worse than it is under current policies is not enough to put the federal budget on a sustainable path. This is not to underestimate the importance of this

first step, both in symbolic and substantive terms. As a symbol, it is particularly important because it will demonstrate a clear break with the approach taken in the first years of this decade when Congress and the President enacted large tax cuts and new entitlement benefits (particularly a new Medicare prescription drug benefit) without offsets and substantially increased both short- and long-term deficits. In substantive terms, it is important because major changes in policies, such as health care reform, that are not paid for would add significantly to the long-term problem.

Of course, merely avoiding making the fiscal problem worse will not avoid the inevitable day of reckoning for the federal budget. As I noted earlier, without changes in current policies, deficits are projected to rise to and remain at unsustainable levels.

Congress and the President will have to take further steps to increase revenues above the level produced under current policies or under the policies proposed by President Obama and, similarly, to reduce spending below the levels produced under current policies or those the President has proposed. Such steps will not be easy, but they are necessary. Ideally, there will be a time in the near future when it is possible for the President and Democratic and Republican Congressional leaders to work together to develop a broad and balanced package of revenue increases and spending reductions that will significantly shrink projected deficits, as occurred in 1990 when President George H.W. Bush negotiated a deficit reduction package with the Congress. In the meantime, it is critical to abide by the pay-as-you-go principle—and to do so in designing a health reform package that is both paid for and contains elements that will facilitate the long-term reduction in the growth of health-care costs.

A failure to deal with the long-term fiscal problem would have very deleterious consequences. Eventually, the run-up in debt would seriously harm the U.S. economy and the standard of living of Americans. It is also possible that even before the debt rises to such levels, the failure to address the problem would lead credit markets around the world to decide that continuing to lend large amounts to the United States to finance its deficits is not desirable, pushing up interest rates and potentially triggering a world-wide financial crisis. It is also clear that spiraling deficits, and any effort to deal with them in a crisis atmosphere, could threaten crucial federal programs that provide assistance to the nation's most vulnerable citizens as well as to veterans, students seeking a college education, and many others. Rather than being addressed, vital unmet needs would grow. Virtually no one in this country will go unharmed if we do not begin to address the long-term fiscal problem in a thoughtful, responsible manner.

Chairman SPRATT. Just to the two of you, let me put a few basic questions.

Do you both agree that process plays a significant part in our efforts to get our hands around this problem and in fact did have a significant role to play in our successes in the 1990s?

Mr. GREENSTEIN. I agree with that. I sometimes think the role of process gets overstated. It is critical, it is necessary, but it is far from sufficient. Nothing substitutes for actually making the hard choices themselves. I think that——

Let me make a distinction. I think process can be very useful as in the pay-as-you-go rules of the 1990s in averting policy decisions that make the problem worse. I don't think process does that much in actually starting to fill the hole itself. For that, we just need policymakers of both parties to start making the tough choices. However, keeping the hole from getting deeper is very important; and process can be very important in helping to accomplish that.

Chairman SPRATT. Mr. Holtz-Eakin.

Mr. HOLTZ-EAKIN. Process certainly matters, but I guess I am going to agree with Bob in that I think it is most useful in cementing policy choices that the Congress has made.

If you can decide which direction you want to head, as in the 1990s, you can use PAYGO budget enforcement and the budget process measures to make sure you don't get off that path. The concern I have about this particular set of proposals is that it takes

the proposals the administration has chosen and says, let us stay on that path, but their budgetary path is a path to disaster.

So I think make some big choices, get us on the right path, and then process the support that that policy decision is a good one.

Chairman SPRATT. Mr. Greenstein, Dr. Holtz-Eakin was critical of the 10-year averaging that is built into this particular proposal. Do you think that is a wise, useful proposal?

Mr. GREENSTEIN. I have mixed feelings about it.

On the one hand, let's take an issue like health care. I certainly think that we need the 10-year averaging approach for health care. We know that measures to slow the rate of growth of health care costs take time. They gradually phase in over time. It would be too great a constriction not to allow that.

On the other hand, I share a concern that you could have in other circumstances a temptation to put all your deficit reduction in some huge effect in the 9th or 10th year, and then it is so big you can't let it take effect.

So I am not positive where I come—I think this needs some further thought in looking at this before you actually move the bill. One possibility might be, unless you think this is too complex, to put in such a 10-year averaging rule for health care reform—I think the circumstances strongly warrant it there—but maybe not apply it across the board to everything, as the administration's proposal would do.

Chairman SPRATT. Doug?

Mr. HOLTZ-EAKIN. I still think that, on balance, it creates more problems than it solves. You know, we have experience with PAYGO rules from the 1990s that were much simpler. They supported, effectively, deficit reduction that had been agreed upon in a bipartisan way. I think that is a good model.

There is an eloquent argument to exempt health care. I do not underestimate the capacity of people to come up with eloquent arguments to exempt every policy that they prefer. So I would pick a simple set of rules. And the 10-year averaging just looks to be too big a hole to drive things through, and particularly in these circumstances where the last thing you want to do is hide things in the out-years. It is the worst thing in this moment.

Chairman SPRATT. A lot of the things we are dealing with have a lot longer time horizon than 5 years. Do you think it is unreasonable to have a 5-year life on this particular proposal? Or should we put it in there, in a sense, in a tentative way to test whether or not it is useful?

Mr. GREENSTEIN. I think that is a good question. A minimum of 5—I think there is a balance. I am not sure I would pass it, and I don't know if it would cost you votes in passing it to try to make it permanent.

I think there is a question as to whether to have a 5-year life or whether to have a 10-year life, but definitely no less than 5 years.

Now, an argument for the 5 years might be that there is some value in getting congressional leaders periodically to reaffirm their commitment to it. You could look at what happened in the late 1990s when, even though we still had PAYGO on the books, we kind of walked away from it.

On the other hand, you could argue that is a bit of a special circumstance. Budget surpluses were reappearing, and people began to take PAYGO less seriously.

So I haven't really thought through whether it should be 5 years or 10. I might have a slight inclination for 10 years over 5, though.

Chairman SPRATT. Doug?

Mr. HOLTZ-EAKIN. I don't think it is obvious, but I think that if you go for something that looks like 4 or 5 years, that is a sensible horizon. I don't think stretching it out to 10 would buy you any additional discipline in the process. And if it looks like it is not working effectively after 2 or 3 years, it is going to be changed anyway. So I think if you, you know, pick 5 years and get started on the process, that would be good.

Chairman SPRATT. Bob Greenstein, Dr. Holtz-Eakin was critical of—as I understood your testimony—the tax measures giving preferred status to the current policy tax measures that were adopted in 2001 and 2003 and the AMT and the sustainable growth rate.

What the OMB has done here really is recognized a political reality and said it is not realistically likely that these will not be renewed, and so let's simply assume they will be for purposes of this particular rule. Do you see fault in that?

Mr. GREENSTEIN. No. As I said in my testimony, I think that strengthens the rule, because going the other route would simply lead the rule to be, right out of the box, all sorts of big waivers. And then we would create an atmosphere in which the routine thing to do was to waive PAYGO.

The only thing I would note there, if we are talking political reality, I would note that—and I think this is the right thing to do—the administration proposed that, with regard to the estate tax, the line be drawn at the 2009, today's current policy. There is a question for you, with regard to the 2001 and 2003 tax cuts, whether you want to draw the pay-as-you-go line at the continuation of the full tax cuts or whether you wanted to take the two top rates, the upper-income provisions, and draw the line there, which would have some parallel to the proposal with regard to the estate tax.

I would note something important in the administration's proposal. If you go the route it proposed, which is to say that extending the full 2001 and 2003 tax cuts is exempt from PAYGO, then it is critical to maintain the provision that they included, under which if you don't extend the full tax cuts, if you roll back the tax cuts at the top, you do not get to spend the savings for something else. That is very important to maintain in the bill.

You can either maintain it as is or what I think might be even better, just draw the pay-as-you-go line to put continuation of the top two rates and a few of the other upper-income provisions on the other side—in other words, apply PAYGO to them.

Chairman SPRATT. Doug, your response to that?

Mr. HOLTZ-EAKIN. I understand the political reality point, and there is something to that. And, in the end, it is a judgment about how to take this step to, sort of, get more discipline in the process.

You know, I will just make a couple of observations about it.

Number one, in the House rules and in the Senate, there has been a waiver for small items, as well. It is not obvious that just the size of the policy drives the desire to waive PAYGO rules. And

so, if it is the case that they get waived, it could be for small items, as well. You have to get the discipline regardless.

The second is that the budget, in the end, is designed to reflect costs. And it is not about the benefits, and it is not about virtues. It is a numerical accounting of the costs of what the Federal Government does. And if the Congress wants to say the benefits of extending these policies are so large that we want to waive the rules, then they should. But that should be done publicly and not embedded in a piece of PAYGO legislation. I think that is a better overall process for policymaking.

And the last thing is, by doing it this way, they are deciding policy. We don't have a consensus policy on physicians' updates. The Congress has done a different thing every year. But they have said zero is current policy. We haven't got a consensus policy on what to do with the AMT. In fact, many different patches have been applied. But they have made an assertion in setting this up that there is a particular way that is the right way. You know, estate tax—you can go down the line. You know, Bob wants to draw the line at a different place on the 2001, 2003 tax policy.

So, you know, I think all of that argues for not giving these preferential treatments, because we don't know what the right treatment is. The assertion by the administration is that they have the right treatment. Congress should have the opportunity to decide that.

Chairman SPRATT. Thank you both for your testimony.

Mr. Ryan?

Mr. RYAN. Thank you, Chairman.

Bob, you just said something that I thought was pretty interesting, and I agree with it. If we don't fully extend all of the 2001, 2003 tax cuts, let's say dividends, capital gains, top rates, which probably is what is going to happen, make sure it goes to deficit reduction, doesn't get plowed into something else, I would like to think we can all agree on that as this thing continues through the process. I believe it is written that way right now.

Mr. GREENSTEIN. It is in the administration's——

Mr. RYAN. Right. So I hope—I think all of us would agree with that. Even though I would prefer to keep those, I hope we can keep that kind of language and that framework put together. And that is something I think we can all have consensus on.

Would you add anything to this bill? Any other enforcement mechanism you have seen, Bob and Doug, that you have liked and that you think ought to be added to this?

Mr. GREENSTEIN. No. The only other change I would consider making—and it sounds like Doug and I have a similar view on this—is, I understand what the administration was trying to do in the rules it is proposing on mandatory and discretionary programs, so that, for example, they don't want you to get credit for savings——

Mr. RYAN. Timing shift——

Mr. GREENSTEIN. No, no, the timing shift stuff is excellent. You want to make sure that, at the end of the 10-year period, you don't move a payday and get credit. And they ruled that out. That is very good.

It is this question about converting mandatory to discretionary programs and discretionary to mandatory programs. The way they wrote it, it has some pluses that would strengthen discipline and some minuses.

But I am worried about the same thing I think Doug is worried about, about the potential to create a new discretionary program, let's say for a year, and then you convert it to a mandatory program and you move out from under the PAYGO.

So I probably—I think we are saying the same thing, Doug and I, on that. I probably wouldn't include that in the bill.

Mr. RYAN. What would you add, Doug?

Mr. HOLTZ-EAKIN. Oh, I guess I would second what I think was the request of the chairman at the end of Dr. Orszag's testimony on finding out exactly what the base is for the sequester. Because if you have a really tiny base and you have a substantial PAYGO violation, it is going to be difficult politically to make it go, and the same kinds of arguments coming into play. So I would worry about the base and broadening it as much as you can.

I would add discretionary spending caps. I think that is the simple solution to all the gaming issues that arise. They have written a very complicated piece of legislation to try to control that, but the simpler way to do it is just to put the caps in and get that enforcement back into the process. And that would be the biggest piece, addition that I think you could add.

The last thing that I, and maybe only I, worry about right now is, given the large current TARP interventions and Fannie Mae/Freddie Mac and what is going on and the continued, what appears to be, use of credit-reform-style scoring for these kinds of financial transactions, I worry about creating something, the initial estimate being a tiny, "Oh, we are only going to lose 10 percent on this," the reality being we are losing 25 or 30 percent, and that additional spending just flying right through here.

So if there was a way to catch that, where the re-estimates revealed exactly what that mandatory process was——

Mr. RYAN. Are you saying we should stick with the original cash basis, or are you saying we should just——

Mr. HOLTZ-EAKIN. I think there are arguments to be made for going back to the original cash basis, number one. I understand the other side of that. But my point is simply, if you are going to do it in a credit reform fashion, which makes sense in some cases, the re-estimates are no longer benign when they are that big and we have this scale of intervention. I don't know quite what to do with that.

Mr. RYAN. In a——

Chairman SPRATT. Bob had——

Mr. RYAN. Oh, go ahead, Bob. I didn't realize.

Mr. GREENSTEIN. I was just going to say I disagree, but let me explain why, with Doug on putting discretionary caps in this bill.

I don't think you need it to prevent the gaming because there is a cap set for each year in the budget resolution. And if you try and move things around, you are going to violate the budget resolution cap.

But the larger reason is the following. Pay-as-you-go keeps you from digging the hole deeper. It doesn't start to address the under-

lying hole itself. It seems to me that the right configuration is we need, sooner or later—sooner is better than later—a bipartisan agreement, the sort of thing that happened in 1990, where we are going to need to take entitlements below the baseline, we are going to need to take revenues above the baseline, and multiyear discretionary caps. I think that is where you put the multiyear discretionary caps.

Mr. RYAN. In a reconciliation kind of——

Mr. GREENSTEIN. It is even larger than reconciliation.

Mr. RYAN. Yeah, a budget agreement.

Mr. GREENSTEIN. Yeah, it is a share the pain, everything on the table, big budget agreement. In such an agreement, I do think multiyear discretionary caps make sense, a la 1990 and 1993.

Mr. RYAN. I like to point to the 1997 one, but, yeah, sure.

In 1965, when Medicare Part A was created, the projection for its 1970 cost was $2.86 billion, and it ended coming in at $4.8 billion. Then its projection for 1985 was $6.8 billion; it came in at $47.7 billion. Its projection for 1990, $8.7 billion; the costs then came in at $65.7 billion.

Now, obviously, benefits got added to it, but we have underestimated these programs dramatically. And are you concerned that we are on the verge of doing the same thing over again?

My concern is, we are creating this new health care entitlement. We are going to have a pay-for package like in 1997, where you cobble together some provider cuts, you cobble together revenue raisers, a mishmash of them, and over the next handful of years, Congress gives them back. I mean, Congress—Ways and Means, I can just tell you, these groups come back and they eat these things back. And what ends up happening is these pay-for packages evaporate, and you have the program growing much faster than ever anticipated, and we have on our hands, then, another huge unfunded liability, new runaway entitlement.

Do you share those concerns? I will just go Bob, Doug, and then I will be finished.

Mr. GREENSTEIN. In other circumstances, I might. I don't that much right now, but let me explain why.

I think the notion of having a health care bill that is fully paid for with hard, scorable savings and then, in addition to that, you put in a number of things that we think will save some money over time, we hope they will—CBO is uncertain, the evidence is not there, and they are not scorable, so you don't get credit for them. But the goal is you have scorable savings that are ongoing and then stuff that you aren't scoring if it turns out it saves you more money.

So I think it tilts things in the right direction if—you raised the key point—if the savings hold. The single most important reason why we need statutory PAYGO is we really need every mechanism we can to lock in the savings that are going to be in the health care bill, should a health care bill be enacted.

The other things that gives me some optimism is we have heard both the President and OMB Director Orszag in the last 5, 6 weeks really toughening the rhetoric, insisting—you know, I think they have put out a very clear message, they insist that the bill be fully paid for with scorable savings. I interpret that to mean, and hope

if the bill is signed we will see further statements by the President, that if there are subsequent attempts to roll back the savings without paying for those, that he would veto such legislation.

Mr. RYAN. Well, we just borrowed $104 billion this week. We are borrowing half of this year's budget. That is the least we could expect, I think, from the administration.

Doug, just to wrap it up?

Mr. HOLTZ-EAKIN. I am very worried about exactly that scenario. You mentioned the 1997 agreement. We basically gave it all back in the end. And that was in an era with PAYGO. So the notion that upfront you would have these hard, scorable savings sounds very nice, but no guarantee that you will get the right result. And so that is a concern to me.

The cost projections are incredibly uncertain. People talk a lot about how the drug bill came in under the projected costs. I am familiar with that. One of the things that I would point out is, you know, it is not all dollars. Incentives matter. That was a bill that was built on competitive bidding by private industry, and, you know, Medicare is not. And so, if you do it Medicare style, we will probably underestimate it and it will be much bigger than we think, so that will be bad.

So I would just say, having watched since 2001 the evolution of the budget pretty carefully, all this rhetoric is quite nice, but it is no substitute for actually doing something about it. Everything that this President has said the last President said, and it is time to actually get some action.

Chairman SPRATT. Any further questions? Mr. Schrader?

Mr. SCHRADER. Thank you, Mr. Chair. Just a few here.

Mr. Eakin, you mentioned or referenced a concern of, you know, the discretionary to mandatory. And I appreciate both the comments on the year-to-year piece. So is there an opportunity for a specific language, perhaps, to be developed to prevent the gaming year to year, as you have alluded to?

Because, certainly, there is adequate, I think, protections in the bill to keep an ongoing discretionary program from just being added, if you will, to the mandatory category and increasing it from there. I think we covered that little piece.

Is there specific language?

Mr. HOLTZ-EAKIN. I don't have some. But if that is something you would be interested in, I could certainly work on it.

Mr. GREENSTEIN. I would just add, I don't think you want to be so rigid as to say that every single year has to balance exactly, or you end up contorting your policies in ways that may not be good policies. So we need to figure out the balance between avoiding gaming but having requirements that are so rigid that they become the enemy of sensible policy development.

I don't have specific language, but we would be happy to think about it more and make some suggestions.

Mr. SCHRADER. We probably don't have a lot of time, but if you all could think about it, that would be very helpful.

Also, to talk to you about—you know, I think it is a little disingenuous by some of my colleagues to talk about the exemptions that are in this bill when, indeed, they have been exempted and not paid for since their inception under the Bush administration.

So I take that criticism with a big grain of salt, quite frankly. However, I think the good news is that Congress and this current administration seems to be wanting to get a handle on those.

I am confused about why we would want to immediately raise taxes on the middle class and lower-income Americans by dealing with them immediately in the midst of the worst recession in history, Mr. Eakin, rather than put it off for a couple years and then, frankly, deal with those things, would be a less detrimental effect to folks in this economy.

Mr. HOLTZ-EAKIN. I am not advocating doing that. I am simply saying that there is this judgment call in writing the legislation about including a specific carveout for those policies. As a matter of the political reality and good economic policy, you are not going to want to raise taxes on people in the middle of a terrible recession. I don't think there is any disagreement about that. And the question is——

Mr. SCHRADER. Some of my colleagues on the other side of the aisle would disagree with that, I think, based on their comments.

Mr. HOLTZ-EAKIN. So the question is, how do you write PAYGO legislation which serves the purpose of broadly enforcing the fiscal discipline—and, I think, including all policies in that is the right way to go—knowing that, ultimately, they have to be waived in certain circumstances?

Mr. SCHRADER. Thank you.

It would seem to me that, while I agree with the comment that a process or a piece of legislation is no substitute for political will, it would be my observation that, prior to PAYGO being instituted in the 1990s in a serious way, along with political will, that things increased dramatically, and we didn't have any control.

So would you say PAYGO is of no use at all, particularly looking at the Bush years when that was abrogated entirely and we ended up with a war off-budget, we ended up with disasters off-budget? Part D may have come in under cost but still was off-budget. It would seem that, by not dealing with it at all, we went back to the merrily-spend-as-you-go thing.

So could both of you comment on that?

Mr. GREENSTEIN. As I said, I think pay-as-you-go is very valuable. I would just—it is not the panacea, as Peter Orszag said. It doesn't itself make the hard choices to start to fill the hole, but it is critically important to help keeping the hole from getting even bigger. And, as you have just noted, in recent years we have just been making the hole even bigger.

Mr. SCHRADER. You know, one of the great trivia games among budgeteers is to try to figure out how much PAYGO contributed to balancing the budget in the 1990s. How much does it deserve credit, versus a big revenue boom, versus everything else that went on? And I think the answer can't be zero, but I really believe that the fundamental impetus was the recognition in the late 1980s that large deficits were a financial threat, the failure of Gramm-Rudman-Hollings because it targeted the wrong thing, which was the deficit, instead of what Congress controlled, which was spending patterns, and that political will turned out to be very important, and the PAYGO rules supported it.

So it had a role, but it is not everything.

Mr. SCHRADER. Last comment.

Mr. GREENSTEIN. Congress made big deficit-reduction actions, took them in 1990 and 1993, and PAYGO locked that in. It prevented the backsliding.

And it is similar to the point I made a few minutes ago in response to Mr. Ryan, that if we get a health care bill that is fully paid for, which would be a major accomplishment, PAYGO can help us lock in the pay-fors and reduce the chances—it is no guarantee—but it reduces the chances of backsliding in subsequent years.

Mr. SCHRADER. Thank you.

I yield back my time, Mr. Chair.

Chairman SPRATT. Bob Greenstein, Doug Holtz-Eakin, thank you, as always, for excellent insights and answers to our questions and for the help you continually give this committee. We very much appreciate your coming today.

One final housekeeping detail. I would like to ask unanimous consent that members who didn't have the opportunity to ask questions be given 7 days to submit questions for the record.

Without objection, so ordered.

The meeting stands adjourned.

[Whereupon, at 12:20 p.m., the committee was adjourned.]