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MID–SESSION REVIEW: BUDGET OF THE U.S. GOVERNMENT

HEARING

BEFORE THE

COMMITTEE ON THE BUDGET HOUSE OF REPRESENTATIVES

ONE HUNDRED EIGHTH CONGRESS

FIRST SESSION

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MID–SESSION REVIEW: BUDGET OF THE U.S. GOVERNMENT

WEDNESDAY, JULY 16, 2003

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

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

Members present: Representatives Nussle, Shays, Thornberry, Ryun, Toomey, Hastings, Portman, Schrock, Hulshof, Tancredo, Bonner, Garrett, Barrett, Diaz-Balart, Hensarling, Spratt, Moran, Neal, Scott, Ford, Capps, Thompson, Baird, Cooper, Emanuel, and Kind

Chairman NUSSLE. Good morning. Today, we are holding a hearing to examine the Office of Management and Budget's mid-session review.

I am pleased to have with us for the first time before the House Budget Committee the very recently confirmed Director of OMB, the Office of Management and Budget, Josh Bolten.

Welcome. Congratulations on your confirmation. We welcome you here today for, I am sure, a spirited discussion about the fate of our budget and your thoughts on that.

As expected, this mid-session review projects substantial short-term deficits and sees the economy as not yet in full recovery. Also as expected, my friends on the other side of the aisle grabbed onto this story yesterday and waved it around as proof positive that the Republican-championed tax relief plunged us into these massive deficits, the likes of which had never been seen before in our history.

Well, I can read the newspapers just like you can. But let me remind us of a little bit of that history.

On September 10, 2001, we were running a surplus, a very large one. We were dealing with the economic challenge of a recession, and thankfully we passed tax cuts in 2001 to deal with that recession, making it the mildest in American history, creating 1.8 million jobs.

So on September 10, while we were running a surplus and while the economy was struggling to get back on its feet, we thought we had the world by the tail. And then September 11 occurred, and just like many Congresses and Presidents before us, we knew we had a job to do. We had a war to deal with. We had a national emergency to deal with and we had economy that had just gotten a gut punch like it had never seen before.

So we did whatever it took to protect the economy and to protect America. And there is not one of us, at least on my side of the aisle, who would ever shrink from that responsibility again or regret the decisions we made.

Many of those decisions were made in a bipartisan way, and appropriately so, because protecting America and protecting our economy should be bipartisan. But now we have a situation to deal with. As the very distinguished new director of the Office of Management and Budget said yesterday, we have deficits and they are manageable, but now we need to manage them.

They are spending-driven deficits. Every Member of Congress knows how we got here. Over the past few years our Nation and economy have been hit with a steady stream of shocks. We fought and won a war. We continue to fight a war against terrorism around the world that we intend to win. We had to shore up our security at home and protect Americans as they work and travel every day.

Let me show you a chart about some of the work that we have had to do. In a bipartisan way, we have enacted supplementals, spending $142 billion since September 11 alone, in order to shore up and protect America. As you can see from this chart, we have spent—in addition to the money that we budgeted for that year—in order to combat terrorism for the emergency. And we did this while the economy was struggling to recover from the slowdown in the recession that began in the middle of the year 2000.

We knew that some of the spending choices we made in the last 2½ years would put an immense strain on the budget. We had to protect America and we had to protect Americans at home while at the same time promoting policies that would grow the economy and create jobs. These obligations supercede everything else that we do here.

Further, these recent spending demands followed several years of very generous spending in a range of government programs. Let me show you chart 16 that shows you the 10-year spending pattern of this Federal Government. As you can see, we have been more than generous with regard to spending.

Since 1995, government spending has increased by nearly 41 percent—41 percent increase since 1995. Looking at individual budget categories, education spending has grown 82 percent; veterans, mandatory spending, 49 percent; Medicare, mandatory spending, 55 percent; and Medicaid, an astounding 77 percent.

So make no mistake, these deficits are promoted and will continue as a result of excess spending.

Second, deficits do matter and spending-driven deficits, I believe, matter even more. And the current deficit is way too big. I can guarantee you, you will not hear me arguing with anybody about the size of the deficit being too large, but I think we have to have a discussion what to do about it.

We can continue to have a great time today pointing fingers at one another; but I read the articles yesterday, and they basically said that is all they heard on Capitol Hill yesterday was finger pointing. We can continue to do that or we can, I suppose, continue to try and spend our way back to prosperity, as some of our colleagues might suggest.

I am sorry there are some who are surprised by these deficits. We all knew in this committee that they were going to be large. That is why we came up with a plan. That is why we wrote and passed a budget and that is why we have to stick to that budget because it will, if we stick to it, get us back to balance. It is why we passed tax relief to create jobs and increase revenues to our government.

Let me show you a chart with regard to this fact, payroll jobs with and without the tax cuts. The tax relief has made a difference—despite what many critics would say. An estimated 1.8 million more people are working today than there would have been without the tax relief, according to estimates.

But those things alone are not going to take care of the deficits. That is just one of the first steps. If these deficits are truly manageable, then let us manage.

We, all of us, Republicans and Democrats, must control spending. I intend to stick to the budget and to the levels in the budget, period. I don't think you can tell me that we can't offset new initiatives or new spending. From what we have already seen in this committee from waste, fraud and abuse, it is very clear that we can.

If Democrats are genuine in their resolve to get back to balance, I welcome them to help in the Republican-led efforts to reduce these deficits by slowing the unsustainable rate of Federal spending growth.

I appreciate Director Bolten being with us here today and I look forward to your testimony. I welcome you to this fight to control spending and get us back to a balanced budget and keep our economy moving forward in a positive way.

And I would like to turn to my friend Mr. Spratt for any comments he would like to make before we hear from our witness.

Mr. SPRATT. Mr. Chairman, I thank you very much.

Mr. Bolten, welcome to your first hearing. We look forward to working with you. Your reputation precedes you, and it is an excellent one; and we are glad to see you in the office you are holding now.

Let me just put a chart up here. It might not be news to you, but it is worth reminding ourselves from time to time that deficits need not be the norm. We changed the fiscal policy of this country in the 1990s. We moved the budget from a deficit of $290 billion in 1992, a record deficit, to a surplus of $236 billion in the year 2000. Every year after the adoption of the Clinton budget—every year, the bottom line of the budget got better to the point where we had the budget in surplus for the first time in 30 years. It was a phenomenal accomplishment.

Mr. Bush, when he came to office, inherited an advantage that no President in modern times has had. As you can see from this chart, in the first fiscal year he was in office, he had a surplus of $127 billion. We have now seen that surplus deteriorate in rapid fashion to a deficit this year of $455 billion. And, Mr. Chairman, let me tell you, we are not surprised. We predicted this.

When you brought out your budget in the year 2001 for 2002, with the enormous tax cuts, we said simply, "We think you are betting the budget on a 'blue sky' forecast. If for some reason these

forecasts don't obtain, don't pan out, we are going to find ourselves right back in the red again and in a big way." And unfortunately, and I take no pleasure in it, that is exactly what has happened.

We had a policy going that was bipartisan at that time. We both disavowed ever again spending the Social Security surplus, anything but Social Security benefits. We were going to buy up outstanding debt, not fund new debt and add to the debt of the United States. We were going to try to buy down the debt held by the public and reduce it to zero by 2008 or 2010 as the first step toward making Social Security solvent.

We have totally lost the trail of what was a truly conservative economic policy, and somehow or another we have got to find our way back to that trail.

The second chart shows you, in a simple linear graph that we are looking right now at the largest deficits in American history. The sag there in 1992 shows what the previous record was $290 billion. $455 billion will be an all-time record in nominal terms, but it only lasts for 1 year. You foresee it is getting better in the year 2005, and we hope that happens; and we do note, as politicians, that it happens to be after the next election.

In addition, we can't forget the forecasting record we have seen over the last several years. Last year, your predecessor came here—same time, same report, the mid-session review—and said the deficit for next year, the deficit for fiscal year 2003 which we now project is $109 billion.

In February, he came back and said, "We have increased that deficit; we think it is going to be $309 billion." That was 5 months ago. And now, 5 months later, you come and tell us it is going to be $455 billion.

So if we are skeptical of your outyear projections, of the improvement from $475 [billion] to $300 billion in the year 2005, that is because we have been burned before. We have seen those projections made in the outyears before only to see them not take place.

If I show you the next chart, what we heard yesterday was a comparison of these deficits in terms of their relationship to GDP, sort of diminishing their significance and saying, Well, these weren't bad; if you look back and compare these deficits as a percentage of GDP to the past they aren't too badly out of alignment with past fiscal history.

A couple of things wrong with that: No. 1, that is to make a norm of a period when we were actually saying, all of us, both sides of the lines, these deficits aren't acceptable. We didn't accept them then as acceptable fiscal policy.

In addition, if you go back in the past, the surplus in Social Security was not a big factor until recent years. We didn't have a surplus in 1983 in Social Security; we were scraping bottom. So if you back out Social Security, and it is off budget, and just look at the on-budget deficits, you can see that the on-budget deficit for 2003 is going to be 5.7 percent of GDP, the gross domestic product. And that happens to be the second largest non-Social Security deficit since World War II.

These are consequential numbers. You can express them different ways, but there is no way around the fact that these are mammoth deficits and a matter of serious concern.

The next chart shows the deficit as a percent of GDP—excuse me the debt, the debt as a percentage of GDP. And you can see after 8 years of improvement, that it is returning to historic highs, too, and it has to be a matter of concern.

Chart 7—this is a different way of saying what the chairman just said. We read a report and we listen to the chairman's comments, and there is a constant refrain for spending restraints, we have got to rein in spending. And we will agree readily that half of the problem, at least, has to be some kind of restraint on spending if we are really going to get a grip on the deficit.

But let us look at where the increases in spending have come over the last three fiscal years under the Bush administration. In fiscal 2001, if you look at current services and the increment, the additional spending over and above what CBO said was required to have current services, and then divide that by percentage into the different accounts of the budget. What you find is that in each of 3 years—in each of 3 years, 93–95 percent of additional spending is in the three categories: defense, traditional defense, DOD; the 9/11 response, New York City and airline response, help to the airlines; and finally the war in Iraq and the war against terrorism generally. That is where a large part of the spending increases come. And I don't know what you are going to do to diminish that; I am not sure we can.

Most of the members here feel we are running—skating on thin ice when it comes to homeland security now, we ought to be spending more. In any event, I don't see how you rein that in. I am not giving up the effort on spending cuts, but that is where the increases have come in the last several years.

I don't get any sense in reading your report of yesterday that you give any culpability to the three tax cuts that this administration has passed—two substantial tax cuts and one stimulus tax cut which we both supported. Let me give you a simple way of looking at what those tax cuts have done to the deficit, the role they play.

Page 6, chart No. 6—I used this last night on McNeil-Lehrer, and we can argue about these numbers, but they are relatively right. If you take all the tax cuts that you proposed over the period 2002–11, add up their production of revenue over that period of time and add in the additional debt service we have to pay because we have a lower surplus due to the fact that we have cut taxes and reduced revenues, they come to 3.746 trillion over that period of time, 2002–11.

If you then take the unified deficit—and this is actually a lower number than you have got because we developed this bar graph before we got your numbers yesterday—the total deficits during that period of time, $3.6 trillion. This is back-of-the-envelope accounting, but the comparability of those two numbers suggests that the tax cuts have indeed had a major role in increasing the deficit to the heights we have seen.

One of the things you acknowledged in your report yesterday is that the estimate of the surplus in 2001, February of 2001, $5.6 trillion, was overstated. We said then, "Mr. President, you are betting the budget on a 'blue sky' forecast of the economy." It turns out we were right.

Instead of having a surplus of $5.6 trillion during the period 2002–11, you now acknowledge that was off by 53 percent for economic and technical reasons. They aren't broken out, but basically it was a misestimate of what the surpluses are likely to be. Forty-seven percent of $5.6 trillion is $2.6 trillion, and your tax cuts have substantially exceeded the available surplus. There is no way around it; doing that simple arithmetic, the tax cuts are a major contribution to the deficits we are looking at today.

My concern is, if we put up chart 5, as bad as these deficits seem, $455 billion this year, $575 billion next year, $1.9 trillion in additional debt over the next 10 years, over the next 5 years it could turn out to be worse. First of all, if you take next year's estimate of a deficit of $575 billion, your estimate, your projection, that does not—excuse me, $475 billion; I don't want to make it any worse than it is you add to that the cost, unbudgeted, of our deployments in Iraq and Afghanistan, which are now running at a rate of $5 billion a month incremental spending, then we could easily have a deficit over $500 billion, maybe $525 billion.

DOD acknowledges they are coming back at us with a substantial supplemental sometime in the next fiscal year, so that $575 [billion] is understated by that factor alone. In addition, you haven't factored into your survey—and by doing a 5-year forecast instead of a 10-year forecast, you skirt this issue—the cost of renewing lots of expiring tax provisions with which—the tax code is now studded as a result of putting expiration dates and sunsets on most of the tax bills we have passed over the last 2, or 3 years.

You call for spending restraint. We don't find any specific cuts in domestic discretion there. We doubt you can do what you want to do and still increase homeland defense, still increase defense. And every time we look at the tax agenda that you present, your administration presents, there is an another omission.

The Treasury is sending us a warning saying the alternative minimum tax is a looming problem. It affects 2 to 3 million taxpayers. Within 10 years, it will affect 39 million taxpayers. We all know, as politicians, it is politically inevitable we will have to deal with that problem sometime in the next 10 years. It will make the marital penalty look like a donnybrook by comparison.

What does it cost to deal with it? Well, if we wanted to hold the impact to just 5 to 6 million families, so it wouldn't hit middle-income families, it would cost $680 billion. If you want to repeat it, it will cost a $1 trillion. That is nowhere factored into any of these numbers, but we know it is coming.

Here we are, pushing other tax cuts, but we continually fail to mention the elephant in the room. The AMT fix will have to be done sooner or later and has to be factored into the numbers because of its inevitability.

So those are the problems that we have, just to mention a few, with what you have projected there, what you have got in your report.

And let me just end with one particular chart, which is chart No. 9; and if you can understand this one, we will give you credit in advanced algebra or something like that. It has got too many lines here. But when I read your report yesterday, I didn't find any compelling sense that this is a problem we had to come together and

come to grips with. I still found the sense that we can grow out of this problem; if we can take it easy and restrain spending a little bit, we can grow out of this problem in 2 or 3 years.

I have been here 21 years and I have heard that argument made before, and the lesson I have learned in 21 years following this problem is, it hasn't worked. It took Gramm-Rudman-Hollings, the budget summit in 1990, the Clinton budget in 1993, the balanced budget agreement in 1997, every one of those budget plans and the process rules that came with it; it took all of that bearing down on the problem over a period of nearly 15 years to finally turn the budget out of deficit and into surplus.

And there is no plan or process proposed in your report yesterday and no sense that we need one now, because if we are lucky, we can grow out of it.

Well, here is what it took, here is what it took to move the budget from a record deficit of $290 billion to a surplus of $236 billion in the year 2000; this is what happened in the Clinton years. If you follow the line, outlays at the top as a percentage of GDP, you will see that in those years, from 1992 onward, outlays steadily declined as a percentage of GDP.

In addition, however, if you look at the bottom blue line, you will see that revenues increase as a percentage of GDP.

CBO did an analysis, looking back at what happened over the 1990s, and they said 48 percent of the reason for eradication of the deficit is due to revenue increases, 52 percent is due to spending cuts.

To succeed, you have to have a tax strategy, a revenue strategy and a spending strategy; and I just don't find that anywhere in the reports you have given us today.

Thank you very much for coming Mr. Bolten, and we look forward to your testimony we have further questions, but I wanted to register those concerns with you before we got started.

CHAIRMAN NUSSLE. Let me just offer, because we have so many members here, I understand that both yesterday and today there has been a lot of concern about the tax cuts and so there is an opportunity in the Congress to repeal them. And, unfortunately, H.R. 436, which is the repeal of the tax cuts, to date only has four cosponsors. So I thought I would help out my good friend Charlie Rangel by passing around a cosponsorship form for H.R. 436, since there seems to be so much concern about the tax cuts.

And you, my friends, whoever on either side of the aisle—I will pass it this direction first—can certainly sign up to repeal the tax cuts if, in fact, they are so problematic.

Mr. SPRATT. Mr. Chairman, you know we supported the child tax credit. We supported the marital tax mitigation provisions. We did, however, vote against the complete repeal of the estate tax; we wanted to reform it and not repeal it. And, in addition, we proposed the suspension of the implementation of the upper-bracket tax cuts.

So we not only supported some of those tax cuts, we voted for them in our own substitutes.

We acknowledge that some tax reduction is needed to get the economy going. But I am just putting the simple arithmetic facts

to you. You cut taxes by way more than the surplus, and as a result, we have a gaping deficit.

Chairman NUSSLE. Well, Dick Gephardt said in Dubuque, IA, his first act as President would be to repeal the Bush tax cuts.

And I will leave it here and—leave it right up here on the table, and if somebody would like to sign up for it, I would be happy to give that back to my friend Charlie Rangel and let him know there is support for repeal. Otherwise, it seems to be more rhetoric than reality.

Mr. Bolten, welcome to the Budget Committee. This is where we have these kinds of discussions and they are usually done in a fairly cheerful way, as I hope you will see today. We know you are a partner in this effort because there is a lot of work to do; and we look forward to working with you on a number of these projects. So welcome. Your entire testimony and the report will be made part of the record, and you may summarize as you wish.

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

Mr. BOLTEN. Thank you, Mr. Chairman, for that very generous welcome. And thank you for welcoming me as a partner for this committee; and I look forward to working with you on both sides of the aisle in the months ahead.

Mr. Chairman, the President's top priorities are: winning the war on terror, securing the homeland, and growing the economy. He has continued to lead boldly on all of these priorities. The President has sought, and many of you in this room—in fact, most of you in this room have supported him in approving the funds necessary for the global war on terror in the defense of the homeland. I know the members on both sides of the aisle have been highly supportive in ensuring that we are able to spend whatever is necessary to support our troops.

The President also acted with Congress in 2001, 2002, and again this year to strengthen economic growth and create jobs, because neither the President nor anyone in this room, I am sure, will be satisfied until every American worker who wants a job can get one. Small business owners now have new incentives to invest and create jobs. Workers are already saving more in their paychecks because of the tax relief and millions of Americans will receive tax refund checks within weeks because of the 2003 Jobs and Growth Act. The combination of these and other policies, and strong economic fundamentals like low interest rates, low inflation and increasing confidence now have the economy poised for strong recovery in the months ahead.

It is in this context that we released yesterday, OMB's annual mid-session review which, as each of you knows, is directed toward updating and revising the estimates of receipts, outlays and the deficit to reflect economic, legislative and other developments since the release of the President's budget in February.

As a result of those factors, a number of factors, including weaker than anticipated economic growth in tax receipts, additional spending for the war on terror, the deficit—as, Mr. Chairman, you and Mr. Spratt have noted—is now estimated to be at $455 billion, well up from the $304 billion estimate released in February.

The number is projected to increase to $475 billion in 2004, after which, in response to the President's program to generate strong economic growth and exercise spending restraint, the deficit is projected to decline dramatically. In fact, by 2006, our projection show the deficit to be half of this year's level in nominal terms, and as you can see from the chart that has just been put up on the screen, even less than half today's level when measured properly as a percentage of GDP.

With the projected shrinkage in deficits, the accumulated level of national debt as a percentage of GDP is expected to be consistent, with the average level over the past half century. And because interest rates are the lowest over the past 40 years, the total amount of interest the government must pay on that debt in 2003 actually declines.

So while large in nominal terms and a legitimate subject of concern, today's deficits are manageable if—and I emphasize "if"—we continue pro-growth economic policies and exercise serious spending restraint.

Placing this year's budget deficit in historical perspective, Mr. Chairman, as you have just done, the most relevant number in measuring deficits is not the nominal figure, it is the deficit as a percentage of the overall economy. With that in mind, a $455 billion deficit, while certainly higher than anyone would like, constitutes 4.2 percent of GDP, well below the post World War II peak of 6 percent and indeed lower than in 6 of the last 20 years. As a percentage of GDP, the deficit, properly measured, while higher than average, is nowhere near a record.

When this administration took office, the budget was forecast, as you noted, by both the administration and by the Congressional Budget Office and many outside economists to run cumulative surpluses of $5.6 trillion over the 10 years from 2002–11. These were good-faith, broadly supported estimates, Mr. Spratt's warnings to the contrary, that took into account no collapse in the stock market, no recession, no September 11 terrorist attacks, no revelation of corporate scandals, no subsequent spending or tax changes, no additional homeland security spending and no war on terror.

But by far the largest single factor in the changes of our budget position has been an economy that has been weaker than originally projected. As you can see from the chart that is coming up now, more than half the change in our 2003 budget position from projected surplus to deficit is due to an economy that has not lived up to April, 2001, expectations.

The tax cuts proposed by the President and enacted by this Congress are not the problem; they are and will be part of the solution. It is important to understand that without any of the President's tax cuts, not 2001, 2002 or 20003, the deficit this year would be at least $278 billion. The combined effect of the three tax packages on the budget balance has been to reduce the surplus by less than a quarter in 2003 and by only slightly more between 2004 and 2008. Had Congress not enacted the President's three tax relief packages, moreover, the economy would be substantially weaker than it is and there would be substantially greater job losses.

Mr. Chairman, as you pointed out just at the outset of your remarks, the most effective way to lower future deficits is to grow the

economy, and the tax packages enacted by this Congress have been very well designed to do that. The key to improving the budget outlook is healthy and sustained recovery with strong job creation. Since the submission of the February budget, prospects for that sustained economic growth have brightened on several fronts.

We have passage of the Jobs and Growth bill. We have successful action in Iraq. We have further reduction in short-term interest rates by the Fed. And we have upturns in consumer and investor confidence. These developments suggest the economy is poised to return to healthy and sustained growth, creating jobs, reducing the unemployment rate and raising incomes.

A healthy economy is essential to an improved budget outlook, but strong growth alone is not sufficient. It is vital to exercise discipline over Federal spending growth while still funding our urgent priorities. Both the President's budget and the budget adopted by Congress pursuant to action by this committee fund the priorities of the war on terror and homeland security while restraining the overall growth of discretionary spending to 4 percent, about as much as the average family income is expected to grow next year.

Restoring a balanced budget is an important priority for this administration, but a balanced budget is not a higher priority than winning the global war on terror, protecting the American homeland or restoring economic growth and job creation. The February budget and congressional action since then reflect the right priorities for this country. Our priorities going forward need to continue to include restoration of strong growth and exercising fiscal restraint.

Mr. Chairman, I am pleased to take your questions.

[The prepared statement of Joshua B. Bolten follows:]

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

The President's budget, released in February, focuses on the challenges posed by three overriding national priorities: winning the war against terrorism, securing the homeland, and restoring strong economic growth and job creation. Significant progress has been made in all three areas.

This mid-session review of the budget revises the estimates of receipts, outlays, and the deficit to reflect economic, legislative, and other developments since February. The deficit for 2003 is now estimated at $455 billion, up from the $304 billion deficit estimated in February, for the following reasons:

• Economic and Other Reestimates. The economic assumptions for this review, discussed later in the chapter "Economic Assumptions," reflect weaker-than-anticipated economic growth since February. Slower growth, lower estimates of wage and salary income, and other economic factors have reduced receipts from the levels estimated in the budget. In the interest of cautious and prudent forecasting, the revised estimates also include a downward adjustment for revenue uncertainty of $15 billion in 2003, $30 billion in 2004, and $15 billion in 2005. These reestimates in receipts are partially offset by lower outlays due to revised economic and technical assumptions. The net effect of all economic and other reestimates is to raise the projected deficit by $66 billion in 2003 and $95 billion in 2004.

• Iraq War. Funding for Operation Iraqi Freedom in supplemental appropriations enacted in April, including costs for military action and reconstruction assistance, increases spending by $47 billion in 2003 and $20 billion in 2004. These estimates do not reflect what the administration has previously indicated are expected but undetermined additional costs arising from ongoing operations in Iraq, extending beyond 2003.

• Jobs and Growth Act. Enactment of a jobs and growth bill that was larger for 2003 and 2004 than proposed in the February budget raises the projected deficit by $13 billion in 2003 and $36 billion in 2004. Of this increase, $9 billion in 2003 and $11 billion in 2004 is due to temporary State fiscal assistance included in the final

enacted bill. In later years, the enacted tax relief is smaller than proposed in the budget, which reduces the deficit projected in those years relative to the February estimates.

• Other Legislation and Policy Changes. Final 2003 appropriations action, non-war related costs in the April supplemental, extension of the program to help unemployed Americans by providing an additional 13 weeks of unemployment benefits, and other policy changes raise spending by $26 billion in 2003, $17 billion in 2004, and smaller amounts in subsequent years.

The reasons for changes in receipts and spending from the February budget are discussed further in the "Receipts" and "Spending" chapters of this Review.

The deficit is projected to increase slightly from $455 billion in 2003 to $475 billion in 2004. As a share of the economy, the projected deficit remains steady in these 2 years, at 4.2 percent of Gross Domestic Product (GDP). These deficit levels are well below the postwar deficit peak of 6.0 percent of GDP in 1983, and are lower than in 6 of the last 20 years.

TABLE 1. CHANGES FROM THE 2004 BUDGET

[In billions of dollars]

	2003	2004	2005	2006	2007	2008
2004 Budget policy deficit	−304	−307	−208	−201	−178	−190
Economic and technical reestimates	−66	−95	−80	−58	−53	−50
Iraqi war supplemental	−47	−20	−1	*	*	*
2003 jobs and growth act	−13	−36	1	30	29	24
Other legislation and policy changes[1]	−26	−17	−16	−9	−10	−10
Total changes	−151	−168	−96	−37	−35	−36
Mid-Session Review policy deficit	−455	−475	−304	−238	−213	−226

* $500 million or less.

[1] Includes debt service on all policy changes.

Even more important, after 2004, the deficit is projected to decline rapidly in response to the economy's return to healthy and sustained growth. By 2006, the deficit is cut in half. Chart 1 shows that the decline is even more pronounced as a share of the economy, falling from 4.2 percent of GDP in 2003 and 2004 to 1.7 percent of GDP in 2008.

Budget deficits as a percentage of GDP are projected to be 4.2 in 2003 and 2004, 2.6 in 2005, 1.9 in 2006 1.6 in 2007 and 1.7 in 2008.

Today's deficits reflect an economy in recovery from recession, increased spending in response to the war on terror and homeland security needs, and the reversal of a massive surge in individual income tax collections. Although large in nominal terms and a legitimate subject of concern, these deficits are manageable if we continue pro-growth economic policies and exercise serious spending discipline.

TABLE 2.—CHANGES FROM APRIL 2001 PROJECTION

[In billions of dollars]

	2002		2003		2004–08	
	Amount	Percent of total change	Amount	Percent of total change	Amount	Percent of total change
April 2001 baseline surplus projection	283	-	334	-	2,578	-
Economic and technical reestimates	−284	64%	−418	53%	−1,782	44%
Enacted policy:						
Tax relief:						
2001 tax relief	41	9%	−94	12%	−761	19%
2002 stimulus act −52 12% −38 5% 19 −*.						
2003 jobs and growth act	-	*	−45	6%	−280	7%
War, homeland, and other enacted legislation	−63	14%	−193	24%	−723	18%
Pending budget proposals	-	*	−1	*	−506	13%
Total change	−441	100%	−789	100%	−4,034	100%

TABLE 2.—CHANGES FROM APRIL 2001 PROJECTION—Continued

[In billions of dollars]

	2002		2003		2004–08	
	Amount	Percent of total change	Amount	Percent of total change	Amount	Percent of total change
Mid-Session Review policy deficit	−158	-	−455	-	−1,455	-

* 0.5 percent or less.
Note: Each change includes associated debt service.

THE TURNAROUND FROM SURPLUS TO DEFICIT

When the administration took office, the budget was forecast by both the administration and the Congressional Budget Office to run cumulative surpluses of $5.6 trillion over the 10 years from 2002–11. These forecasts were good-faith estimates that took into account no subsequent spending or tax changes, no recession, no collapse in the stock market, no September 11 terrorist attacks, no revelation of corporate scandals, no additional homeland security spending, and no war on terror. As shown in Table 2, the largest factors behind the subsequent change in surplus estimates are a weaker economy than originally projected and other reestimates in receipts and outlays, such as weaker capital gains realizations and higher growth in health care costs. These reestimates account for 53 percent of the change in the 2003 budget balance from the $334 billion surplus estimated in the April 2001 budget to the current estimate of a $455 billion deficit.

By far the largest reestimate from the April 2001 projection has been in receipts. In the late 1990s, revenue from the individual income tax surged far above historical rates of growth, due to increased capital gains realizations from a booming stock market, growth in stock options and bonus income to high-income taxpayers, and other factors. At the height of the revenue surge in 2000, total receipts came in nearly $300 billion above long-term historical trends. This receipts "bubble" more than accounted for the $236 billion budget surplus in that year. The administration's April 2001 projection, like those of the previous administration, the Congressional Budget Office, and other forecasters, assumed this level of receipts would continue. The subsequent reversal of the receipts surge has brought today's receipt levels far below the original April 2001 estimates.

Policy actions account for the remainder of the change in the budget outlook since April 2001. The President proposed, and Congress enacted, three major tax bills in the past two and a half years. The first tax cut, the Economic Growth and Tax Relief Reconciliation Act of 2001, came just after the economy had entered into recession. Its immediate tax relief in the summer and the fall of 2001 boosted consumer demand and helped to ensure the recession was short and shallow. The second tax cut, the Job Creation and Worker Assistance Act of 2002, provided incentives for business investment to jump-start the recovery. This spring, Congress passed the Jobs and Growth Tax Relief Reconciliation Act of 2003, proposed by the President in January to strengthen the recovery and accelerate job creation from its current subpar pace. In 2003, the effects of these three tax cuts account for 23 percent of the change in the budget balance from the original April 2001 projection. Even without these tax cuts, the deficit this year would be projected at $278 billion and, of course, the economy would have been even weaker had the tax cuts not been enacted, with substantially greater job losses.

Policy action on the spending side of the budget has also increased the deficit. The largest spending increases, in the areas of defense and homeland security, came in response to the terrorist attacks of September 11, 2001 and the ensuing wars in Afghanistan and Iraq. The effects of this and other new spending account for 24 percent of the change in the budget balance since April 2001.

PROSPECTS FOR THE ECONOMY AND THE BUDGET

The key to improvement in the budget outlook is a healthy recovery with strong job creation. Since the submission of the budget in February, prospects for sustained economic growth have brightened on several fronts:

- Passage of the President's jobs and growth tax package will stimulate consumer spending, improve incentives to work, and encourage individual and business investment.
- Successful action to free the Iraqi people from the regime of Saddam Hussein has removed uncertainty about the timing and outcome of the war.

• A further reduction in short-term interest rates by the Federal Reserve last month and historically low long-term rates provide an attractive climate for investment and a strong housing market.
• Upturns in consumer and investor confidence indicate economic improvement is in the offing.

All of these developments combine to suggest that the economy is poised to return to healthy and sustained growth creating jobs, reducing the unemployment rate, and raising incomes.

A healthy economy is essential to an improved budget outlook because it generates more revenue and reduces the pressure for spending in unemployment-sensitive programs. But strong growth alone is not sufficient. It is vital to exercise discipline over Federal spending growth, keeping new policy action within the framework set by the President's budget and this year's congressional budget resolution. Both the budget and the resolution fund the priorities of the war on terror and homeland security, while restraining the overall growth of discretionary appropriations to a 4-percent level, consistent with the average growth in family income. If discretionary spending instead continued to grow at the average 7.4 percent rate experienced between 1998 and 2003, it would add a cumulative $400 billion to the deficit over the next 5 years.

Holding discretionary spending to 4 percent growth overall requires us to make choices, to set priorities, and to exercise fiscal discipline. Even in priority areas such as homeland security, we must be sure that funding increases are well spent. The administration's efforts to assess and improve the performance of Federal programs across the government, discussed further in the chapter "Progress Implementing the President's Management Agenda," will help to ensure that taxpayer dollars are directed to programs that provide the greatest benefit.

It is important to restrain increases in mandatory as well as discretionary spending to the levels envisioned by the budget and the resolution. Proposals for concurrent receipt of military retirement benefits and veterans' disability compensation, and increases in highway spending above the levels in the budget, are examples of new proposals however well-intended that have the potential to undermine the fiscal framework designed to move the budget toward balance. The administration renews its call for budget enforcement mechanisms that will restrain policy action above the limits set forth in the budget and the resolution.

While we work to improve today's budget position, we must keep in mind the real fiscal danger: the unsustainable long-term finances of the nation's two major entitlement programs. Even if the budget were in balance today, the growth in the future costs of Social Security and Medicare beyond their dedicated resources would create deficits that grow ever larger as a share of the economy in the decades to come. The President is committed to reforming these programs in a way that modernizes their benefits and restructures their financing to ensure that they provide benefits not only for those in or near retirement today, but for generations to come.

The fundamentals of the economy remain sound. With renewed economic growth, and with judicious stewardship of the people's money, we can return the budget to a stronger position in the years ahead.

Chairman NUSSLE. Thank you for your testimony and for your words of wisdom and partnership today.

And I am struck by your comment—and I want to go back because I haven't heard this number before—if we did nothing, if we didn't cut taxes, we would be in deficit?

Mr. BOLTEN. Mr. Chairman, we would be in large deficit today, at least $278 billion in deficit, if none of the tax cuts had never taken place. And I want to add that that number does not take into account the very salutary effect that the tax cuts have had on the economy and, therefore, on Treasury receipts.

We would be at least $278 billion in the red today without the tax cuts, probably worse.

Chairman NUSSLE. I mean I haven't heard that story before. No one has reported on that. I haven't seen that on the chart.

So if the Rangel bill was adopted, or had been adopted, or if we had not adopted the tax relief, not only would 1.8 million people not be working today who are currently working, but we would still be in deficit?

Mr. BOLTEN. Very deeply in deficit, Mr. Chairman. And I would add, we would also be in a much worse economic situation.

What caused these deficits in the first place? The principal reason for the deficit in the first place was very sluggish economic growth and slow receipts in the Treasury. Without the tax cuts, we would be in a very similar situation with little prospect of pulling out, because we would not have the stimulus in the economy that the tax cuts have already provided and have a very strong promise of providing in the months ahead.

Chairman NUSSLE. Now, I understand that the next argument that is going to be made though is, well, we can get back to surplus sooner than 2008 and 2009. Does anyone want to bet the farm on those numbers?

I hope the argument here today is that doing nothing really should not have been an option here, and that is why doing something was so important. And I want to show another chart, chart No. 9. Not only was cutting taxes important and doing nothing is not an option, but let us assume for a moment that we would adopt the Democrat proposals, these first 7 months with regard to mandatory spending, on the floor of the House. Just look at what the deficit would have been then.

Look at what the drug bill would have done that they put on the floor for a trillion dollars. Welfare, unemployment, I mean, you know, it goes on and on.

Just run through these charts real quick. There is Medicare. That is the increase, $579 billion increase, to the deficit. The deficit that we are talking about today, that is being complained about, is the "worst in history." Let us adopt the Democratic Medicare proposal and watch it grow.

What is the next one you have got? Well, that is not it. I was on a roll—welfare, $52 billion added to the deficit. I know, I am getting a few things off my chest.

So, OK, doing nothing is not an option. I would suggest as humbly as I can that this kind of excess spending is not an option and that is why I am arguing as forcefully as I can here today that you have got to stick to the plan, to the budget. It has two components. It has growing the economy, as the Director suggested, so we can get people back to work who are looking for work, so they can make money and pay taxes. And the second component is controlled spending.

And I would like to go to that—and I know this is, in the grand scheme of all these bar charts, not a lot of money. It is in Iowa. A lot of money—I think it was said in Des Moines, IA, "a million here and a million there add up to a lot of money." But let us look at the supplemental, just as an example, $1.9 billion; I am calling for this to be offset.

Back before we were at surplus, we used to offset supplementals, emergency spending around here, with lower-priority reductions so that we could build in for the higher-priority emergencies. And we are only—gosh, please I hope my mother is not hearing me saying only $1.9 billion—but only in the grand scheme of all these big numbers we are throwing around here, I would say, Mr. Director, can we offset, can we find $1.9 billion of waste, of lower-priority

items so that we can fit this in and not go any deeper and begin the trend again?

We are not talking about a war. We are not talking about a national emergency or a terrorism attack. We are back to the deficits we saw at the time when we had a practice to offset them.

I know you can't do that. It is obviously Congress' job to offset, but will you help us try to find the necessary offsets to offset the supplemental that is before Congress?

Mr. BOLTEN. Mr. Chairman, we didn't send that supplemental up with offsets. We would be glad to work with you on that. It is obviously a difficult and complicated process, especially as we approach the end of the fiscal year, because we need those offsets in fiscal year 2003, and that is emergency spending that we need in 2003 in order to combat fires and hurricanes and things like that. And I am glad to work with you on that, and I am glad, in looking forward, to cooperate with you in a process where, in fact, we do seek offsets for items that go outside the budget.

And on that subject, Mr. Chairman, I very much welcome the words of Mr. Spratt, who, when he spoke about restoring mechanisms—statutory mechanisms to restrain the budget, we are very much in support of that, and I look forward to working with the committee on that as well.

Chairman NUSSLE. Let me take one more minute and suggest one pet peeve that I have in this regard.

We notoriously—we hope to God it doesn't happen, but we know it is coming next year—floods, forest fires; it is terrible to know that they are coming, but we notoriously do not provide resources ahead of time to budget for that. And so we then stand at the underfunded FEMA accounts and say, "Oh, my gosh, what are we going to do?" These are so high-priority emergencies that we have to deal with, we have got to spend more money, we have to pass a supplemental.

And I would suggest to you, part of the reason we got back to the practice in the mid-1990s is because I think a forceful case was made that these are predictable. We don't know exactly where and when, but we know we are going to help people in need. That is our job in many of these instances, to help people who cannot help themselves. And I would hope that not only we start with a relatively—I had better use that word—"small" supplemental while we can, so we set up the practice for a time when it may be a little more difficult and where we had more time to plan.

And part of the reason I say this, I don't want to make 455, 456.9 or 460, we don't want to go any deeper is the old adage when you are in the hole. Spending is what is driving this, and I want to do whatever we can even on the margins even when it is relatively small.

Mr. Spratt.

Mr. SPRATT. Am I correct in reading your report yesterday that the current estimate, restated estimate of the surplus between 2002 and 2011 is actually $2.6 trillion; not $5.6 trillion, as presented and projected in January of 2001, but $2.6 trillion?

Mr. BOLTEN. No, Mr. Spratt. I don't think so.

Mr. SPRATT. You stated the surplus was overstated by 53 percent because of economic and technical mistakes.

Mr. BOLTEN. I think that was just in 1 year. But in fact, the $5.6 trillion surplus was overstated by more than $5.6 trillion if we look at the actual reality of what happened. I think the 53 percent relates to——

Mr. SPRATT. Just 1 year?

Mr. BOLTEN. Is it 2003—the change that is directly attributable to the—to economic effects as opposed to either spending, which was the second largest contributor in 2003, and the tax cut, which was the last.

Mr. SPRATT. Now the tax cut you have got there is actually the tax cuts passed with the expirations assumed. You have got 31 percent of the problem is due to tax cuts.

That is just for the year 2003?

Mr. BOLTEN. I think we estimated 23 percent for the year 2003.

Mr. SPRATT. That is for tax cuts?

Mr. BOLTEN. Yes, sir.

Mr. SPRATT. I saw a chart that had 31 percent for tax cuts.

Mr. BOLTEN. Between 2004 and 2008.

Mr. SPRATT. For the whole 5-year period of time?

Mr. BOLTEN. And, Mr. Spratt, we actually did assume throughout that period that all of the tax cuts in the Jobs and Growth bill were extended. None are assumed to sunset and all of the other extensions of tax provisions that were contained in the President's budget were also extended.

Mr. SPRATT. Just 26 percent.

So do these percentage allocations hold over the 10-year period of time? Are they roughly right for all 10 years?

Mr. BOLTEN. We didn't run precise numbers over the full 10 years, but I am told that it doesn't change by that much over the full 10-year period, by the rough—again, back of the envelope.

Mr. SPRATT. Could you give us for the record a pie chart that shows 2002–11 of how much is diminished of that total pie due to economic and technical miscalculation and how much has diminished due to tax relief, tax measures passed and still to be passed that are part of your agenda?

Mr. BOLTEN. We will give you what we can that—at least what we can reliably report on.

[The information referred to follows:]

MR. BOLTEN'S RESPONSE TO MR. SPRATT'S QUESTION REGARDING LONG-TERM PROJECTIONS

The administration mid-session review of the budget updates estimates of the changes in the April 2001 projection through 2008. We have limited our estimates to five years due to the high level of uncertainty in longer term projections. Table 2 in the mid-session document allocates the change among economic and technical re-estimates, tax relief, and other legislated changes. Attached is a pie chart that shows the source of the change by category. The largest cause was economic and technical re-estimates which accounted for 47 percent of the total. As your requested, we have also attached a table that shows the distribution between economic and technical re-estimates.

TABLE 2.—CHANGES FROM APRIL 2001 PROJECTION

[In billions of dollars]

	2002–08	
	Amount	Percent of total change
April 2001 baseline surplus projection	3,195	
Economic and technical reestimates:		
Economic	−833	
Technical	−1,651	
Subtotal, reestimates	−2,484	47%
Tax relief:		
Enacted policy:		
2001 tax cut	−897	
2002 stimulus act	−71	
2003 jobs and growth act	−325	
Subtotal, enacted	−1,293	25%
Pending tax proposals	−218	4%
Subtotal, enacted and pending	−1,511	29%
Other:		
War, homeland, and other enacted legislation	−979	19%
Pending spending proposals	−289	5%
Subtotal, other	−1,268	24%
Total change	−5,264	100%
Mid-Session Review policy deficit	−2,069	

Note: Each change includes associated debt service.

Mr. SPRATT. You estimate that in the years 2004 and 2005, the budget will begin to get better, actually sort of comes down to a new plateau that is beneath $400 billion. It is the $230 and $304 billion, I believe, in 2005.

What do you a attribute that to? Is it all economic growth?

Mr. BOLTEN. No. A great deal of it is economic growth, and the faltering of economic growth is what created these large deficits in the first place. So a very large chunk of it is economic growth.

But we are also assuming a pretty good dose of spending restraint like was contained in the budget resolution that this Congress approved.

Mr. SPRATT. By our calculation, if we are to have the kind of growth you appear to assume during that period of time, the economy has to start growing now, this quarter, at about a 4 percent annual growth rate. And that has to continue in order to attain a 2.8 percent fourth quarter, over fourth quarter result.

Do you think the economy right now is growing at 4 percent? Is there a surge that is happening right now that we are not aware of?

Mr. BOLTEN. Mr. Spratt, I think what we have assumed is roughly for the second half of this year a 3.7 percent growth rate in the economy. And that——

Mr. SPRATT. That will average out to 2.8 percent for the full year.

Mr. BOLTEN. Yes.

And that estimate, I am told, is straight down the middle. Corresponds with what CBO estimates and what the Blue Chip estimators are estimating has well. So I think it is a sound and, I understand, relatively conservative estimate.

Mr. SPRATT. My time is just about up.

You mentioned that you are game to the idea of having the budget process rules that we put in the Budget Enforcement Act of 1991 renewed. In rewriting or extending the PAYGO rule, would that apply to taxes as well?

Mr. BOLTEN. Going forward, we would be prepared to consider that.

Mr. SPRATT. Thank you sir.

Chairman NUSSLE. Mr. Thornberry.

Mr. THORNBERRY. Thank you Mr. Chairman.

Mr. Bolten, let me add my welcome to this committee. I have been a member of this committee for about 5 years now, and the one thing that I continue to be struck by is how rotten we are at predicting revenue coming in to the government. And if we could put up chart 1, which is similar to what you were talking about with Mr. Spratt, if you kind of start at the top and work your way down, this is what has happened with the downturn receipts.

The blue is tax relief, and that is a debate we have back and forth, but ultimately the democratic process runs its course and a bill is or is not passed, is or is not signed into law; and so at least tax rates are something within our control. And obviously part of the downturn in the receipts are the deliberate result of bills passed by Congress and signed by the President.

And then the next level down, our spending increases. Again, we have a debate; that is something within our control. And a lot of those spending increases in some areas are more than I would like; other areas, perhaps not as much as I would like—in homeland security, perhaps. But we have disagreements and ultimately we take action and there are results.

But then we come to the red. And the red, as your chart shows and this chart shows, dwarfs everything else. Part of that is just the flow of the economy, improving or not improving, or actually going down. But there is even an element—CBO has testified before to us that even with the economy performing at a certain level, the revenues coming into the Federal Government are less than what would be expected of the economy performing at that level, so it is not just economic growth.

There seems to be a lot that we don't know and are not very good at predicting. And I guess what I would like to know—and I understand you have been in this position a short time—do you have suggestions about what any of us can do to do better at predicting, or even budgeting, going into the future?

We know the top things are under our control and the results are the decisions that we make, but this huge red area in this chart, which is the result of economic forces that we can't, at least directly, control, presents us with difficult problems. Do you have suggestions on what we can do better again at predicting or at budgeting or to have a little better estimate in the future?

Mr. BOLTEN. Mr. Thornberry, I think you are targeting exactly one of the right problems, which is—a lot of the misestimates have come on the revenue side, that the very rosy projections of huge surpluses were radically wrong about government receipts. And that is an area where we need to improve our projections.

It is interesting that where the receipts seem to have fallen off the most is in some corporate taxes, especially in individual income taxes and capital gains taxes. It seems that there is a steep fall-off in tax receipts, particularly from wealthy individuals, unrelated to any tax cut, but I think it had to do with the stock market collapse, with options and so on that built up in the late 1990s and the beginning of this decade.

So it is a real problem in the estimates. It is one that I think the economic estimators are getting better at, but there is a great deal of work to do.

One thing we can do is be conservative in our estimates going forward, and we did that in the mid-session review. We have inserted into our estimates a plug that is just a guess, that the estimates may be too optimistic even though we think we have been conservative. We have inserted a plug into our numbers of $15 billion in 2003, $30 billion in 2004 and $15 billion in 2005 for precisely the problem you are talking about, which is an over expectation of revenues.

So we feel we have been on the conservative side of this. We have got $60 billion in just the first 3 years of our projections that we have put into the estimates for any unexpected further shortfall in revenues. And I think we need to do that going forward until we are better at estimating how revenues come in.

Mr. THORNBERRY. I agree. Thank you very much.

Chairman NUSSLE. Mrs. Capps.

Mrs. CAPPS. Thank you Mr. Chairman.

And thank you Joshua Bolten, for being here for your first hearing.

At the last mid-session review a year ago the President said the fiscal year 2003 budget deficit would be $109 billion. In January, the President said it would be $304 billion. Today, in a tour de force of fiscal recklessness, the expected fiscal year 2003 deficit will be $455 billion. This represents a stunning 300 percent increase in 12 months.

Despite this, the administration and the Republicans in Congress have no plan to address the deficit—no real plan. In fact, the argument is being made that the White House may see the fiscal damage this causes as an added benefit of this reckless policy. This is the starve-the-beast strategy Republican operatives speak of so glowingly. The way to keep spending down is to keep cutting taxes and drive up the deficit. Then, the argument goes, there is no way to spend money on programs and services that the American people ask for.

These tax cuts do mostly benefit the richest people in the country. And the programs we underfund—Head Start, Medicare, education, veterans health—are most important to middle-class and working families. It is a cynical and destructive strategy that hurts families today and saddles our children and our grandchildren.

And my question to you, Mr. Bolten, is a statement that you are quoted as making that "these deficits are manageable." My question is, at what level would you consider the deficits to be unmanageable either in dollar amount or in percentage of GDP?

Mr. BOLTEN. There is no fixed answer to that. I don't know where the situation gets difficult.

Chairman Greenspan was asked the same question yesterday. He doesn't know where the situation is.

What I can tell you is that the deficits we are experiencing today, although much larger than we would like them to be, are manageable.

Where we would see a problem is in long-term interest rates. And long-term interest rates—from a deficit that is too large. Long-term interest rates today are at 40- or 50-year historic lows. So we are not seeing the current deficits causing a problem in the economy. And I think this needs to be—whenever we look at the deficit picture as a percentage of GDP we need to be assessing what is the effect on the economy.

The situation today is indeed manageable, and if our projections prove correct, and I think as I was just discussing with Mr. Thornberry, I think they are conservative, going forward, we will see the deficits declining in just the next few years to about 1.7 percent of GDP which should put even less strain on the economy.

Mrs. CAPPS. But long-term interest rates are long term. And surely there must be some way to estimate either 5 percent of GDP or 6 or 10, the point at which you could predict that that would affect long term—there is no way?

Mr. BOLTEN. Mrs. Capps, no, I don't think there is. Because there are so many different factors that affect the economy. We could be looking at high unemployment and yet a low-growth rate. We could be looking at high interest rates. So there are so many different factors at play that I don't think any economist would hazard a guess at what the right number is. So what I can tell you is that today a 4.2 percent of GDP deficit, while much larger than we want, is not causing substantial damage to the economy.

Mr. BAIRD. Would the gentlelady yield for a moment? You answered her earlier by saying that interest rates have not been impacted by the deficit so, therefore, it must not have a negative impact. But now you are saying they are unpredictable, their relationship. Seems inconsistent.

Mr. BOLTEN. I don't think so. The point I was making was that when you assess whether a deficit is causing damage to the economy, you need to look at the whole economic picture. That means what is the employment level, what is the productivity level, what are interest rates and so on. This is how the markets and the economists do it. I think that is how we all ought to be doing it as we cautiously evaluate what is the right step to be taking.

Mrs. CAPPS. Could I reclaim my time? I do want to ask you a question. I hear you saying there is no ceiling on how big deficits can get without causing damage.

Mr. BOLTEN. No, that is not what I said. I said you can't predict in the abstract exactly what that number is.

Mrs. CAPPS. I do want to get out the fact that the mid-session review shows a gross decrease of $25.5 billion in Medicaid spending for fiscal years 2004–08. I would like you to explain the causes behind the drop in Medicaid spending.

Mr. BOLTEN. I don't have those with me at hand. If I could provide that for you for the record, I will.

Mrs. CAPPS. Could it be that the States are cutting Medicaid benefits and tightening eligibility criteria for this program, and isn't

this projected decrease in spending a real negative effect on Medicaid beneficiaries?

Mr. BOLTEN. I will give you an answer for the record, Mrs. Capps.

Mrs. CAPPS. Thank you.

[The information referred to follows:]

MR. BOLTEN'S RESPONSE TO MRS. CAPPS' QUESTION REGARDING THE CAUSES FOR THE DROP IN MEDICARE SPENDING

Under the fiscal year 2004 MSR estimates, Medicaid spending is estimated to grow at an average rate of 8.1 Percent over the next 5 years compared to the fiscal year 2004 President's budget estimate of 8.7 percent. This growth rate is slightly smaller than was previously forecast in January. The estimates reflect a combination of anticipated changed in state Medicaid programs and revised economic assumptions. In 2003–04, medical assistance spending is projected to increase by $9 billion over the January estimates, primarily as a result of the Jobs and Growth Tax Relief Act of 2003. This legislation gave states temporary increase in their Federal matching rates.

Chairman NUSSLE. Thank you. Mr. Hastings.

Mr. HASTINGS. Thank you, Mr. Chairman. Mr. Bolten, welcome to what I hope will be a first of many pleasant experiences in front of the Budget Committee. We have heard today, of course, a number of reasons why we are running deficits, largely all because they were unpredictable prior to, I would say 9/11. A lot of factors came into that. That is been, I think, well-documented. However, a lot us came to this body thinking that balancing the Federal budget is a very good policy. And so what I would like to ask you, just for the record, in view of the difficulties that we are going through, does the President still share that goal of having a balanced budget?

Mr. BOLTEN. Yes, he does.

Mr. HASTINGS. That is pretty unequivocal. I like to hear that. In the last exchange that you had with some of the other Members there, the interests or the issue came up regarding interest rates, and critics of deficit spending have said over a long period of time that when you run deficits, that tends to crowd out the markets and, therefore, interest rates rise. And yet, I can speak on a personal basis that I have refinanced and interest rates continue to come down. How do you explain that phenomena right now? And should there be other considerations that go into effect when you are looking at the economic impact when we talk about deficit spending?

Mr. BOLTEN. Well, that is what I was just beginning to get into with Mrs. Capps, which is that there are a whole wide variety of factors in an economy that will affect what interest rates, what long-term interest rates are going to be. They do include the level of employment. They include very significantly the productivity rate, that is the rate by which we are able to produce more goods with less labor. They include international factors like growth rates abroad and how receptive are foreign countries going to be to our exports. So there are a whole wide variety of economic factors that come into determining interest rates.

And the main reason we need to be worried about deficits in the short run is because we need to ensure that they are not causing substantial upward pressure on those interest rates. Today with a 4.2 percent of GDP deficit, too large, we are not seeing that upward

pressure on interest rates. And that is why I have use the world manageable to describe the situation.

Mr. HASTINGS. Just out of curiosity, I know back in the '80s the deficit as a percentage of GDP was somewhere around 6 percent. Do you know what they were after the Second World War, say during the '50s when we were growing up?

Mr. BOLTEN. Oh, I think immediately after the Second World War they were very large. The government ran huge deficits during the war. They fell off after that fairly rapidly. But let me turn to my colleagues to see if we have a specific answer.

Mr. Hastings, in the interest of the time of the committee, we will be able to give you a chart for the record. But during wartime, traditionally, the numbers have gone well above 6 percent of GDP. That 6 percent peak is just in the last 20, 30 years.

[The information referred to follows:]

MR. BOLTEN'S RESPONSE TO MR. HASTINGS' QUESTION REGARDING THE DEFICIT AS A PERCENTAGE OF THE GDP

The Highest post-war deficit as a percentage of GDP was in 1983, at 6 percent. For most of the 1950s, deficits were below 2 percent of GDP. During the Second World War, deficits reached over 30 percent of GDP. The attached table shows deficits as a percent of GDP from 1930 through the administration's estimate for 2008.

SUMMARY OF RECEIPTS, OUTLAYS, AND SURPLUSES OR DEFICITS (−) AS PERCENTAGES OF GDP: 1930–2008

[In billions of dollars]

Year	GDP (in billions of dollars)	Total			Year	GDP (in billions of dollars)	Total		
		Receipts	Outlays	Surplus or deficit (−)			Receipts	Outlays	Surplus or deficit (−)
1930	97.5	4.2	3.4	0.8	1970	1,013.2	19.0	19.3	−0.3
1931	83.9	3.7	4.3	−0.6	1971	1,081.4	17.3	19.4	−2.1
1932	67.7	2.8	6.9	−4.0	1972	1,181.5	17.5	19.5	−2.0
1933	57.6	3.5	8.0	−4.5	1973	1,308.1	17.6	18.8	−1.1
1934	61.2	4.8	10.7	−5.9	1974	1,442.1	18.3	18.7	−0.4
1935	69.7	5.2	9.2	−4.0	1975	1,559.8	17.9	21.3	−3.4
1936	78.5	5.0	10.5	−5.5	1976	1,736.7	17.2	21.4	−4.2
1937	87.8	6.1	8.6	−2.5	TQ	454.8	17.9	21.1	−3.2
1938	89.0	7.6	7.7	−0.1	1977	1,971.3	18.0	20.8	−2.7
1939	89.0	7.1	10.3	−3.2	1978	2,218.6	18.0	20.7	−2.7
1940	96.7	6.8	9.8	−3.0	1979	2,503.8	18.5	20.1	−1.6
1941	114.0	7.6	12.0	−4.3	1980	2,732.1	18.9	21.6	−2.7
1942	144.2	10.1	24.4	−14.2	1981	3,061.6	19.6	22.2	−2.6
1943	180.1	13.3	43.6	−30.3	1982	3,228.6	19.1	23.1	−4.0
1944	209.0	20.9	43.7	−22.8	1983	3,440.5	17.5	23.5	−6.0
1945	221.3	20.4	41.9	−21.5	1984	3,839.4	17.4	22.2	−4.8
1946	222.7	17.6	24.8	−7.2	1985	4,136.6	17.7	22.9	−5.1
1947	234.6	16.4	14.7	1.7	1986	4,401.4	17.5	22.5	−5.0
1948	256.4	16.2	11.6	4.6	1987	4,647.0	18.4	21.6	−3.2
1949	271.5	14.5	14.3	0.2	1988	5,014.7	18.1	21.2	−3.1
1950	273.4	14.4	15.6	−1.1	1989	5,405.5	18.3	21.2	−2.8
1951	321.0	16.1	14.2	1.9	1990	5,735.6	18.0	21.8	−3.9
1952	348.8	19.0	19.4	−0.4	1991	5,930.4	17.8	22.3	−4.5
1953	373.4	18.6	20.4	−1.7	1992	6,218.6	17.5	22.2	−4.7
1954	378.0	18.4	18.7	−0.3	1993	6,558.4	17.6	21.5	−3.9
1955	395.2	16.6	17.3	−0.8	1994	6,944.6	18.1	21.1	−2.9
1956	427.7	17.4	16.5	0.9	1995	7,324.0	18.5	20.7	−2.2
1957	450.7	17.7	17.0	0.8	1996	7,694.6	18.9	20.3	−1.4
1958	461.1	17.3	17.9	−0.6	1997	8,185.2	19.3	19.6	−0.3
1959	492.1	16.1	18.7	−2.6	1998	8,663.9	19.9	19.1	0.8
1960	518.9	17.8	17.8	0.1	1999	9,137.7	20.0	18.6	1.4
1961	531.8	17.7	18.4	−0.6	2000	9,718.8	20.8	18.4	2.4

SUMMARY OF RECEIPTS, OUTLAYS, AND SURPLUSES OR DEFICITS (−) AS PERCENTAGES OF GDP: 1930–2008—Continued

[In billions of dollars]

Year	GDP (in billions of dollars)	Total			Year	GDP (in billions of dollars)	Total		
		Receipts	Outlays	Surplus or deficit (−)			Receipts	Outlays	Surplus or deficit (−)
1962	568.5	17.5	18.8	−1.3	2001	10,021.5	19.9	18.6	1.3
1963	599.7	17.8	18.6	−0.8	2002	10,337.3	17.9	19.5	−1.5
1964	641.3	17.6	18.5	−0.9	2003 estimate	10,746.4	16.3	20.6	−4.2
1965	687.9	17.0	17.2	−0.2	2004 estimate	11,265.6	16.0	20.2	−4.2
1966	754.2	17.3	17.8	−0.5	2005 estimate	11,828.7	17.2	19.8	−2.6
1967	813.5	18.3	19.4	−1.1	2006 estimate	12,413.4	17.8	19.8	−1.9
1968	868.4	17.6	20.5	−2.9	2007 estimate	13,023.6	18.1	19.8	−1.6
1969	949.2	19.7	19.3	0.3	2008 estimate	13,671.4	18.1	19.8	−1.7

* 0.05 percent or less.

Note: Budget figures prior to 1933 are based on the administrative budget concepts rather than the unified budget concepts.

Mr. HASTINGS. Mid-'80s, if my memory serves me correctly. Well, I just want to say that—I am one of these that don't like to—I don't think it is good policy to run deficits, but I do think that the proper measurement, when you do have deficits, is what is what in relationship to the overall economy. So I think that is an important point. I do want to emphasize that.

And I thank you for your time, and again, I hope you have other pleasant experiences here.

Mr. BOLTEN. I am enjoying it so far, Mr. Hastings.

Mr. HASTINGS. Yield back.

Chairman NUSSLE. Mr. Emanuel.

Mr. EMANUEL. Thank you, Mr. Chairman. Thank you Director Bolten for being here. Using your own numbers, I think I am doing this right, we are going to have added, or have added nearly $3 trillion to the Nation's debt and 3 million Americans have lost their jobs. As we say back in Chicago, such a deal. And that has been the consequences, whether you want to say it is taxes, you want to say it is spending, those are the facts. That is what is there so far. Not that other people won't find jobs who so lost them, and we may actually begin to turn our deficit around, but based on your numbers, $3 trillion will be—nearly $3 trillion will be added to the Nation's debt. And as of now, in this meeting a net 3 million Americans have lost their jobs.

Now, I want to read you something from the State of the Union and have you been in this job a little too early but it is the President's State of the Union. His quote is, "We will not deny, we will not ignore, we will not pass along our problems to other Congresses, to other Presidents and to another generations." As I look at those 24 words, I have almost the instinct to ask you who wrote those words for the President? Because it is really inconsistent with about $455 billion in deficits and almost the lackadaisical approach about $3 trillion being added to the Nation's debt.

I was struck, as Congressman Spratt was, by the tone in which—that we will—the lack of urgency about the Nation's debt being increased. I was struck by it because yesterday in front of the Financial Services Committee, the Fed chairman had a very different attitude about the deficit. He says the deterioration in the unified budget has been mirrored in a sharp downsizing in Federal saving.

Net Federal saving fell from a high of a positive 2 percent of GDP in 2000 to a negative two and a half of GDP in the first quarter of 2003. With little change in the non-Federal domestic saving over this period, the down sizing in the Federal saving showed into net national saving which is equal to less than 1 percent of GDP in the first quarter compared with a recent high of 6.5 percent of GDP in 1998.

If not reversed over the long haul, such levels of national saving could eventually impinge on the formation of private capital that contributed to the improved productivity performance of the past half-decade.

Now, you are right, in the sense that deficits don't really matter there. Whether they become as they are now or they become perceived by the market as structural, that will have an impact on the interest rates. But there is no doubt that it is going to have an impact on the savings rate. As Chairman Greenspan said in his own testimony, there is a sense of urgency on its impact on savings and what it will do to fund the growth.

We can all talk about tax cuts. We can all talk about spending. The fact is if it impinges on savings, we cannot have the economic growth that is necessary to fund the growth that we need. I would like to—this is more of a philosophical question because you do, hopefully—I think you are doing your job well, serving your President, being loyal to his economic plan, but the lack of sense of urgency of what these deficits will do to savings that can fuel economic growth is—I am taken aback by because I know you have private sector experience, and you know without private savings, there will be no economic growth.

Mr. BOLTEN. Mr. Emanuel, I agree with everything that Chairman Greenspan said.

Mr. EMANUEL. That is a good place to start.

Mr. BOLTEN. And I think those are all important points. The administration does have proposals that were included in our budget to encourage long-term savings in the form of lifetime savings account and retirement savings account and so on. And we are going to be very interested to work with you and the other members to see those adopted. In the short run, in the short run, our problem is not the savings deficit we have in the country, our problem is an economy that has been far too weak. It is that economy that caused the deficits. And that is the—the policies that the President has put in place are the ones that have are best suited to get us out of that problem in the first place.

Mr. EMANUEL. Director Bolten, I would agree that you need to stimulate the economy. It could be accomplished with certain spending areas that are good for both short-term, as well as long-term economic growth, but if you look at the tax cuts, no disrespect meant here, a slight difference of opinion, in 2003 the only piece of that tax cut that was stimulative was the one that Democrats had offered in the sense of a tax cut immediately that went into effect right then and there. And only 10 percent of the $350 billion that was just passed goes into effect. The bulk in the back end of 2008. You may be worried, but you are not worried about your projections in 2008 because you are not projecting one. We have one now, 3 million Americans have lost their jobs.

So with all due respect, tax cuts, yes, they can be helpful to an economy. And philosophically, yes, they can be helpful in moving the economy, but if they are not here and now and not in people's paychecks, which they are not, it is whether they hit people's paychecks today. Less than 10 percent of the $350 billion tax cut went to the economy in 2003. Fact.

Mr. BOLTEN. I don't agree with your numbers to begin with, Mr. Emanuel, but I think the people who will be getting the checks that are going into the mail at the end of this month won't agree either. I think there is a substantial stimulative effect to the tax cuts that have been introduced. There is a Treasury study came out yesterday showing a 2-percent increase in GDP as a result of the tax cuts. And I think the right measures have been taken.

Mr. EMANUEL. Director Bolten——

Chairman NUSSLE. The gentleman's time has expired. If you have a final question, go ahead.

Mr. EMANUEL. It would be a statement, not a question. I will try to make it as a question. Director, the Fed chairman noted the importance of the Child Tax Credit yesterday as part of growing the economy. And I would note that, yes, people who receive their checks at the end of this month will feel the impact on that. Unfortunately, 6.5 million families, 12 million children will be left out. I think they would also like to participate in this growing economy.

Mr. BOLTEN. The President supports that.

Mr. EMANUEL. Thank you for that.

Chairman NUSSLE. Mr. Schrock.

Mr. SCHROCK. Thank you, Mr. Chairman. And welcome from me as well. You are having a good time now, but it is not over yet. Let me—I am going to address the tax reduction thing and ask you a question, but I want to make a comment first.

I heard one of the members a minute ago say that the tax cuts we have had or the tax cuts for the rich and, of course, as we get closer to the 2004 elections those will be the 10- and 20-second sound bytes you will hear over and over again. But let me tell you what it means to one person that I met. We bought a place here, I had the carpet changed a while back, a couple months ago. I had a young man who is the carpet installer for a carpet company. I was there. It was a Saturday. He said to me, I hope you don't mind me saying this, but he says, I think what you guys do down there as far as tax cuts are absolutely wonderful. A lot of my buddies and I agree. It is probably going to afford my wife and I the opportunity for the first time in our lives to buy a house that we haven't been able to buy. And that story can be told over and over and over again by a lot of small businesses. So frankly, I think the tax cuts, if that—he said to me, do I look rich? I said, well, no. I don't want to be insulting, but no you don't look rich. He said, it does help a lot of people like me and will continue to do that.

So what I think the President has done in this Congress under the current leadership is very, very good for the economy. And frankly, I think the President is doing a great job. It is a terrible situation to have to deal with this stuff. And everybody talks about the surpluses we were going to have; those were projected. If the sun came out every morning, everything was rosy, well it didn't. We had some folks on 9/11 who decided they were going to change

some of that, plus a lot of other things. I think, that taken into consideration, we have to realize we are probably not as bad shape as we could have been if this President hadn't taken some of the actions he took.

I know you answered in this your testimony, but I am going to ask it again because I want everybody to understand. Did the tax reductions, the tax reduction policies over the last two and a half years, cause the deficits described in the mid-session review, and if not, why not? I don't think we can tell that over and over again enough to make people understand.

Mr. BOLTEN. The tax cuts adopted in 2001, 2002 and 2003 were a relatively small contributor to the deficit on a static basis. And the most important thing is that because they do reduce government receipts somewhat, the most important thing is though that the principal cause of the large deficits we are seeing today is a downturn in the economy and attendant much lower Treasury receipts than we would like to see. And the tax cuts have been both well-designed looking back and especially looking forward to restore the economic growth that ultimately will restore the deficit picture.

Mr. SCHROCK. And a President, no matter how good he may or may not be, has no impact on that. I mean they may be the most brilliant people in the world, but the economy is going to be cyclical whether a Democrat or Republican is sitting in the White House. It just happens to be this guy is a Republican and that is when things started to happen. Am I right or wrong?

Mr. BOLTEN. Sure. The stock market peaked in early 2000. The country was entering recession already when the President took office in early 2001. The corporate scandals that came to light last year and the year before had been brewing throughout the 1990s. All of these factors are baked in, regardless of who was the President, and then we were hit with the shock of September 11 and the global war on terror. So all of these things come together to suggest that it is a pretty tough situation that this country has faced in the last 12½ years. I would argue that the right measures have been taken to mitigate the damage caused by the external situation and to bring us back to a good budget picture.

Mr. SCHROCK. I would agree with you. According to your estimates, roughly how much of the deficit do you think resulted from the economic factors and how much from spending?

Mr. BOLTEN. If I could have one chart back up, the pie chart. This one if you will look in—if you are looking at the year 2003, the year we are now, we see the economy explaining more than 50 percent of the deficit. And I would emphasize again that this is a static look. This is not take taking into account the positive effect that the tax relief has had on the economy, meaning actually mitigating the deficit picture.

Mr. SCHROCK. I agree. Thank you very much. Thank you for being here. Thank you, Mr. Chairman.

Chairman NUSSLE. Mr. Thompson.

Mr. THOMPSON. Thank you, Mr. Chairman. Thank you, Mr. Bolten for being here. I would like to get back to something that Mr. Spratt brought up that was the issue of the Budget Enforcement Act. In your report, you actually mention that the adminis-

tration supports extension of the now expired Budget Enforcement Act but in manners that are consistent with the President's budget proposal. Given the fact that without the tax cuts, the deficit would be, you know, roughly a little less than half of what it is today, I guess I have trouble understanding what bringing back the act consistent with the President's spending proposal actually means, given that PAYGO is a major component of that. And if you have—and the leader on the other side, Mr. DeLay, on the floor of the House already stated that he believes there are some more needs and budget room for even greater tax cuts, and there is no PAYGO that goes along with it, so it seems somewhat contradictory. If you could answer that. And also let me know, is the administration going to be pushing, in the fiscal year 2005, budget reenactment of the Budget Enforcement Act?

Mr. BOLTEN. Consistent with the President's budget, we mean going forward, beyond the President's budget, we would, of course, what is already out there, we would be prepared to look at the imposition of the cap, PAYGO and the caps that were——

Mr. THOMPSON. So we could actually be in greater deficit and greater debt than we were today before you consider budget enforcement enactment?

Mr. BOLTEN. I don't think that is necessarily true. But we are—actually, I will very much look forward to working with members on both sides of this committee in the year ahead. As we prepare the 2005 budget—in answer to your second question, as we prepare the 2005 budget, to see what we can agree on in terms of new budget enforcement mechanisms. I think they are very useful and they are important.

Mr. THOMPSON. So will the administration then be asking for reenactment of the Budget Enforcement?

Mr. BOLTEN. I can't tell you specifically what will be in the 2005 budget proposal now, we are still a ways off from that. But my own inclination would be to work with you to try to see that we can put something in there.

Mr. THOMPSON. If Members try to bring that about before the 2005 budget, you would be willing to work with us and be supportive of that?

Mr. BOLTEN. We will work with you before then.

Mr. THOMPSON. Appreciate that very much. One other thing on your report, several points indicate that deficits would be manageable if we were to exercise serious spending controls. But then it also states that the largest spending increases have been in the area of defense and homeland security. And given the, I think, terrible news that we heard this week that the cost of $5 billion a month between Iraq and Afghanistan and that seems like things are still pretty unpredictable there and depending upon what happens in Liberia, these costs that you state as the largest spending increases and already stated today as the top priority, may actually grow. So does that mean that the only serious spending control that we see will be in the nondefense discretionary programs?

Mr. BOLTEN. Well, what I can tell you is that the President will spend what is necessary to defend the country and the homeland and to support our troops. And my expectation is he would have support from both sides of the aisle in doing that.

Beyond that——

Mr. THOMPSON. That is not the question. The question is where will the serious spending controls be focused?

Mr. BOLTEN. Well, we will have—we will be looking at very hard at the nondefense, nonhomeland portion of the budget, but we also need to look at the whole budget. We need to be serious as well about defense and homeland security to be sure that we are spending the people's money wisely. The one thing you can be sure of though, that if the spending is actually related to our national defense, and if it is related to supporting our troops in the field, the President will insist on spending what is necessary, and I expect he would have a lot of support up here to do that.

Mr. THOMPSON. But I am assuming we will also look at appropriate expenditures there, we are going to make the right financial—the right fiscal choice there is as well.

Mr. BOLTEN. I hope so.

Mr. THOMPSON. Well, we hope so. Hope we get a little greater commitment than just hope. Thank you.

Chairman NUSSLE. Just to report to the gentleman too, there is a little known or little reported title in the Medicare bill which is a $33 billion savings proposal that is promoted by this committee in waste fraud and abuse. So we are starting the process and not just the discretionary side, but also on the mandatory side. Mr. Bonner.

Mr. BONNER. Thank you, Mr. Chairman. Mr. Bolten, welcome. I am a new Member of Congress. I have only been in office for about 6½ months, although I worked up here for about 18 years. So I have had an opportunity during my time in public service to meet a lot of people back in any district. One in particular that I met just a couple of days ago told me about frustration he has had, and I mention this in hopes of soliciting help out of your office in dealing with waste, fraud, and abuse.

This gentleman lives in Orange Beach, AL. He has been fighting cancer and was recently in a hospital where he had a procedure done. It cost $1,500 and Medicare reimbursed $5,500. When he contacted the hospital and when he contacted Medicare, they both said, well, it is really very difficult to fool with the $4,000 overpayment; so we are just not going to worry about it.

I worried about it. Because I think that $4,000 here and $4,000 there eventually adds up to a lot of money. I applaud our chairman because this committee, just in recent weeks, has invited Inspectors General from many of the Departments to come in and help identify other areas of fraud and abuse. So I use that as an example to ask this question, can we get from the Office of Management and Budget a commitment, I know this administration has only been on the job for a little over 2 years and a lot of these are systemic problems that have occurred in administrations over the decades, but can we get some assistance from the administration, an assurance that as we bring to the different departments and agencies, examples of overpayment and abuse, that you will work with us in Congress to identify them and to try to put an end to it? Because that certainly has an effect on the overall level of government spending.

Mr. BOLTEN. Absolutely, Mr. Bonner. I know the chairman has been interested in this subject for some time. We do at OMB have an initiative on erroneous payments that we are serious about putting a lot of effort into. A large portion of the erroneous payments that we have now in the government, which are estimated in the billions and billions of dollars, do occur in the Medicare program. We would like to be sure that we get after those dollars because those are dollars that we need to spend actually giving people the care they need.

Mr. BONNER. Well, you are right. Chairman Nussle has done an admirable job on that. I want to publicly thank him for his efforts on it. I would now like to invite to you come into the——

Chairman NUSSLE. You have an extra couple of minutes now for that too, just so you know.

Mr. BONNER. Thank you, Mr. Chairman. I would like to invite you into the buzz saw, if you will. As an observer of what has gone on for the last 6 or 7 months. I find myself sometimes scratching my head in bewilderment over what I hear from some of my colleagues in this committee, and on the House floor, demanding that the tax cuts have just ripped apart our economy and caused all these high levels of unemployment. And that the doom of western civilization, as we know it today, is on the horizon. And yet, amendment after amendment is offered on the floor and in committees to increase spending. So my question to you is, if we were to accept some of these amendments that have been offered over the last 6½ months that would increase spending whether it is for homeland security, we are not spending enough there, or for Medicare, we are not spending enough there, or for education or for whatever the program, would not all of these increases in spending also turn around and increase the deficit that they also decry as being the worst thing since the creation of this country?

Mr. BOLTEN. They would, Mr. Bonner. I thought Chairman Nussle had an exceptionally good chart that details exactly that in some pretty stark reality.

Mr. BONNER. Thank you, Mr. Chairman. I appreciate the additional time, but I yield back my remaining time.

Chairman NUSSLE. Mr. Baird.

Mr. BAIRD. That is a dapper tie you have.

Chairman NUSSLE. You got an extra 2 minutes. This is not hard.

Mr. BAIRD. Mr. Bolten, what is your understanding of a lockbox?

Mr. BOLTEN. To tell the truth, I don't really have an understanding of what some in the public debate mean by it when they say a lockbox.

Mr. BAIRD. The President of the United States of America ran for office as did many of the members of this institution promising to put Medicare and Social Security in a lockbox. Is that your recollection?

Mr. BOLTEN. The—it is actually not my recollection with respect to Medicare.

Mr. BAIRD. Let's take Social Security.

Mr. BOLTEN. Social Security there was general acceptance that it is good—it is good practice top off the Social Security surplus.

Mr. BAIRD. If that is the case—on page 1, the second paragraph of your document—the deficit for 2003 is now estimated at $455

billion. Does that reflect the lockbox that we all promised to put Social Security trust funds in or is that including the so-called lockbox to lower the actual appearance of the deficit?

Mr. BOLTEN. There is no appearance being played here. The $455 billion number does include the Social Security surplus, but that is always been the practice with respect to estimating the unified deficit. And it is the right measure, I should say, when assessing what effect is the deficit having on the economy. That is the purpose for which we are using it.

Mr. BAIRD. If the Congress were to level with the American people and honor our pledge it set aside the money in a lockbox instead of borrowing it for other purposes what would the deficit be?

Mr. BOLTEN. The unified deficit would—I am not sure what you mean.

Mr. BAIRD. The on-budget deficit.

Mr. BOLTEN. Again, I am not entirely clear on what you mean.

Mr. BAIRD. Let me say it this way: How much are we borrowing from Social Security, Medicare in your projections?

Mr. BOLTEN. The concept is not borrowing from Social Security and Medicare.

Mr. BAIRD. It is a concept that we debated for hours ad nauseam in this Congress 2 years ago. And the President talked about it on the campaign trail, as did many of our own candidates.

Mr. BOLTEN. Well, the money that is set aside for Social Security is an accounting set aside. That moneys there too pay current and future retirees. If what you are getting at is that we face a long-term problem with an unfunded liability, I agree completely. That is an issue that we do need to address going forward. It is not—it is not the current problem with the deficit. The current problem with the deficit is one in which we need to restore economic growth.

Mr. BAIRD. I can help you out from your own materials, I believe. It looks to me like in 2004 you are planning to borrow $164 billion from Social Security, Medicare and the on-budget deficit projection from your own document would be $639 billion not, in fact, $4 [billion]—whatever it was—$50 billion. So actually, the deficit, if we honored or pledged to put Social Security and Medicare in a lockbox, the deficit exceeds $630 billion is that correct?

Mr. BOLTEN. I don't see it that way.

Mr. BAIRD. The President seemed to during his campaign. Let me ask a second question. Our President seemed to. You mentioned to Mrs. Capps earlier that interest rates did not seem to be affected by the current deficits. It is an interesting economic theory. My understanding is that the Federal Reserve is largely responsible for setting interest rates. Is that accurate?

Mr. BOLTEN. As far as governmental entities that can have some substantial effect on interest rates, the Fed is the one that has the strongest hand on the levers.

Mr. BAIRD. My further understanding is it those rates are low largely an attempt to stimulate the economy. Were those rates lowered by the Fed due to actions by the Congress or the President or was that an independent opinion of the Federal Reserve Board?

Mr. BOLTEN. The Fed is highly independent.

Mr. BAIRD. So if the Democrats or Republicans in the Congress try to take credit for lowering those interest rates that would be fallacious would it not?

Mr. BOLTEN. If the Republicans or Democrats tried to take credit for Fed action that has an effect on interest rates, yes. But that would not be a proper thing to do, unless they have some influence that I am unaware of. But there are a lot of other factors that affect interest rates. And those include the kind of spending rates that the President and the Congress agree on, and those we should, we do and should take responsibility for.

Mr. BAIRD. Let me add one other point. We talk about the deficit. There are choices in how you get into deficit. One choice might to be spend $50 billion, for example, as we propose in the Transportation Committee to build roads and bridges to put people back to work, a tangible public asset that has value over the long term and employs people today and really stimulates the economy with a useful resource. The contrast to that is $50 billion tax cut that goes back to me, but it is hard to see a direct job created. So I would favor the former.

When Mr. Bonner talked about the increase in the deficit, I find it ironic that you mentioned no stimulative effect at all of the increased spending which I think would have a stimulative effect but only talked about stimulative effect of tax cuts. I find that specious. I yield back.

Chairman NUSSLE. Mr. Hulshof.

Mr. HULSHOF. Thank you, Mr. Chairman. Mr. Bolten I have no talking points. I have no designed questions to put you or the administration on the spot. I am less interested here today in assigning blame.

Mr. BOLTEN. Why should you be different, Mr. Hulshof?

Mr. HULSHOF. I have less interest in assigning blame. I am really more interested in the facts and just a couple of observations. I guess that is one of the advantages of going toward the end is hearing other colleagues. And I would say to my friend from the State of Washington, this whole discussion about the lockbox, I think inherent, in that, of course, was the idea that we would not be in a recession, that we would not have a national emergency, that we would not be engaged in a war. I know in a number of pieces of legislation, for instance, to have a Constitutional amendment to balance the budget or some other enforcement mechanism, we anticipate in times of emergency that we would relax the rules. And I think, obviously since September 11, we have taken on a number of those unique and hopefully once in a lifetime events.

Mr. BOLTEN. All absolutely true, Mr. Hulshof.

Mr. HULSHOF. Also, I want to emphasize a point that Mr. Schrock made in passing, and I wanted to emphasize that the—we go back to prior projections and, you know, the $5.6 trillion projected surplus was just that. It was a guess. I think back and some of my colleagues that were here, my friend from Massachusetts, Mr. Neal, we worked on the committee back in 1997, Mr. Neal, we worked in a bipartisan way on the Balanced Budget Act to have a glide path over the next 5 years, from 1997, to have a balanced budget. We did it, or actually the American people did it for us, in half the time. So even our best projections, we saw better results

in balancing the budget. True on-budget surpluses, Mr. Baird, that did not have to borrow from any trust fund.

And again, so we make these calculated guesses based on the best information we have available. And ultimately, then we come back and we get to Monday morning quarterback whether we or you were right or wrong. In fact, I think back to, I think now economists, main stream economists, are pretty accurate when they say that the malaise or the economic recession actually began in the last quarter in 2000, which was unanticipated at the time.

So again, we can go back and revisit history and some would even revise history, but I am more interested really in where do we go from here? That is why I want to focus just a little bit on the economic assumptions, specifically on pages 12 and 13. And just before doing that, again, I see my time. I am trying to see if there is some part of your—the tie has been taken, but——

Mr. SHAYS. You can try intelligence.

Mr. BOLTEN. The chairman's hair looks real good.

Chairman NUSSLE. Regular order.

Mr. HULSHOF. I would also say, again, another quick point to my friend, and he is my friend, from the State of Washington regarding interest rates. It was interesting that the rhetoric, and I wasn't here in 1994 and 1995, I was seeking this seat in those years and was unsuccessful, but it was interesting that the political rhetoric that was there was a direct causal relationship between if you had surpluses and interest rates. I remember making the arguments if we balance the budget, we will see a 2-percent cut in the interest rates which will be great for American families. And I think now economists, and we have to be honest that there is not that direct link between budget surpluses or budget deficits and what,in fact, happens with interest rates. In fact, over a dozen or so interest rate cuts that have been made since we have gone into a recession.

So again, just a quick observation. You pointed out, again, I want to make sure this is certain for the record, that over the second half of 2003, you are projecting about a 3.7 percent growth rate; is that right, Mr. Bolten?

Mr. BOLTEN. That is correct.

Mr. HULSHOF. Which ultimately translates into about a 2.8 percent increase in the growth rate for the year; is that also true?

Mr. BOLTEN. Correct.

Mr. HULSHOF. Also, for 2004 and 2005, you also project somewhat stronger growth; what are those numbers?

Mr. BOLTEN. I am looking at, if I am looking at the right line here, we have 3.7 percent and 3.5 percent in 2004 and 2005 as projected growth rates. Again, I think those are entirely consistent with main stream blue chip economists' forecasts as well as the CBO.

Mr. HULSHOF. Is it true, again, I guess I am going backwards now, but is it true that Federal Government receipts have declined? This is the third year in a row that we have seen government receipts decline?

Mr. BOLTEN. True.

Mr. HULSHOF. The last time that we have had three consecutive years of government receipts actually going down was is it true that it was during the period of the Great Depression?

Mr. BOLTEN. Yes, 80 years ago, something like that.

Mr. HULSHOF. Again, thanks for your presence here today.

Thank you, Mr. Chairman.

Chairman NUSSLE. Mr. Neal.

Mr. NEAL. Thank you, Mr. Chairman.

Mr. Hulshof is my friend, and he is a good guy, but let's revisit history. Incidently, the gentleman from Missouri seemed to derive the notion of projections in the previous administration and then looked to you to give us projections that probably are more accurate for this administration. But let me read to you a quote here from February of 2001. It is called "A Blueprint for a for New Beginnings, a Responsible Budget for America's Priorities." I believe your office generated this report. This is the quote, "In sum there is ample room the administration's budget to pay off the debt as far as possible, to reduce taxes for American families, to fund program priorities and still leave roughly $1 trillion for Medicare modernization and to meet any other programmatic and contingency needs as they arise." do you continue to agree with that position?

Mr. BOLTEN. No. And I don't think anybody else does either. That was written in February 2001 before the extent of the stock market collapse was clear, before recession had been officially declared, although it was probably as Mr. Hulshof just pointed out, underway at that point, before corporate scandals came to light, and especially before the September 11 attacks and the war on terror.

Mr. NEAL. You no longer agree with that position that was offered here in the budget projection?

Mr. BOLTEN. No.

Mr. NEAL. OK. Next question.

Mr. Bolten, is it your position this morning, are you arguing here this morning that these tax cuts where we have taken $2 trillion from the Federal budgets will pay for themselves?

Mr. BOLTEN. In terms of direct in and out of the Federal Treasury, no. I don't think anybody knows exactly what the effect is. But no, I am not arguing that.

Mr. NEAL. I would assume that you would argue that these three tax cuts passed since 2001 have been helpful for our economy? Because I know the talking points that were referenced earlier which are used by the other side, often say it would have been worse. So could you clear that up? Do you think they have been helpful to the economy?

Mr. BOLTEN. Oh, I think they have been essential to the economy.

Mr. NEAL. OK. What about their effect on the economy over the long run?

Mr. BOLTEN. The effect of these tax cuts on the economy over the long run, I think, should be even more positive than they have been already, because some of these tax cuts as Mr. Emanuel was earlier pointing out, do take time to take effect. But in the both the short, medium, and long run, I think all of the tax cuts are highly positive for the economy because they put the incentives where they belong for people to work, save and invest.

Mr. NEAL. Do you have a high opinion of the Joint Tax Committee here?

Mr. BOLTEN. Yes, I do.

Mr. NEAL. Would you say an extraordinary opinion of Joint Tax?

Mr. BOLTEN. I will reserve on that until I hear your question.

Mr. NEAL. Well, I am going to get to that in a moment. That is how we will close. I compliment the chairman on his tie and suit, and then we will decide whether we can compliment you on your answer. You mentioned that the tax cuts have had a static effect on the deficit of one quarter to one-third. Are you familiar with the dynamic scoring that has been done by the Joint Committee on Taxation, on the most recent tax proposal?

Mr. BOLTEN. I know they have been working on it, but I am not familiar with the details of it.

Mr. NEAL. You are not familiar with the details of it. Do you agree or disagree with their conclusion that these additional tax cuts, adding to our deficit, will perhaps boost the economy slightly in the short term but will be harmful in the long run?

Mr. BOLTEN. No, I disagree. I know the Joint Tax Committee has been working, as have economists in many other places, to come up with a suitable measure so that we can accurately gauge what the effect of—the dynamic effect of a tax cut is on the economy. We are working on that ourselves. And I think the art and science of economics has not yet advanced to the stage where we can properly capture all the positive effects that the tax cuts do have on the economy.

Mr. NEAL. Do you hold the Joint Tax Committee in high regard, Mr. Bolten?

Mr. BOLTEN. I do.

Mr. NEAL. Do you agree with the conclusion they have drawn?

Mr. BOLTEN. I do not.

Mr. NEAL. Mr. Bolten, let me ask you this last question. Do you find it astounding that a political party that based much of their modern history on fighting communism and deficits would now adopt a position that deficits don't count?

Mr. BOLTEN. I might, but I don't think there is a party of that nature. This administration certainly has never adopted the posture that deficits do not count. We take the current deficits very seriously. What I did say is that we believe these deficits are manageable, given our current economic situation, and that the tax cuts that contributed in small measure to those deficits have, in fact, been essential to restoring economic growth to this economy which is what is going to be important in the long run in bringing the deficit down.

Mr. NEAL. Mr. Bolten, I look forward to your testimony at Ways and Means.

Mr. BOLTEN. Thank you, sir.

Chairman NUSSLE. Mr. Diaz-Balart.

Mr. DIAZ-BALART. Thank you, Mr. Chairman. Mr. Bolten, thank you for being here. You know, I am really new here. I am just always amazed at what we hear from our dear friends from the minority party. All of a sudden, they have this huge interest in concern for the deficit, and yet at the same time, they say that their actions are totally different. You know, it is amazing, you can say anything, but facts don't bear out what they are saying. They have proposed $890 billion increase to that deficit that all of a sudden

they say they are concerned about, and yet, not only that, they didn't even support Chairman Nussle's cut of 1 percent of fraud.

Mr. NEAL. Would the gentleman yield?

Mr. DIAZ-BALART. I had very little time. So, Mr. Neal, you just had some time, so let me finish my question. They didn't even support the 1 percent cut on waste fraud and abuse that Chairman Nussle proposed. It looks like, again you can say anything, but the facts don't bear that out. Spending is clearly, I think, a bit of a problem. You know, you can't lose weight and continue to eat. You can't lose weight and not only continue to eat, but continue to eat pancakes and lard as your diet.

Economist Robert Simulson recently stated, he wrote that government spending has to be paid for, which is not rocket science, either through taxes or deficits, and that both can put burdens on the economy. He argued, therefore, that government spending is the problem, as some of us have been saying, and it must be controlled. Do you agree with that statement or argument, and if so, what specifically is the administration going to be looking at proposing to control spending?

Mr. BOLTEN. I do agree, Mr. Diaz-Balart. And the administration has already, in its own budget proposals and in the budget resolution adopted by this committee, I think made a major step toward exercising some important spending restraints. I think the chairman's initiatives to pursue waste fraud and abuse are important, and we are working on our own end to pursue those as well. And I think you will see in the budget that we present in 2005, and hopefully beyond, enhanced measures to try to make sure that we are—we are being as careful with the taxpayers dollars as we possibly can be.

Mr. DIAZ-BALART. Mr. Bolten, I am not really good at math. So I want to make sure I am not misunderstanding something. When people who say they are determined about the deficit, but when they propose $890 billion additional toward that deficit, can that do anything to get us out of the deficit?

Mr. BOLTEN. It would make the situation substantially worse.

Mr. DIAZ-BALART. Again, Mr. Chairman, I will not ask for additional time, even though I do like your tie, by the way. But I just want—I keep saying and I keep repeating, Mr. Chairman, what I keep saying, I know that maybe as a new Member of this Congress and this committee, I am just not used to hearing and I am not used to hearing it and I am not used to accepting so much doubletalk. You cannot on one side of your mouth say that you are concerned about deficits, and at the same time go to the floor of this Congress and argue for $890 billion in increased spending and say that we are cutting when we are not. Because some of us think, if anything, we are spending too much.

So Mr. Chairman, begging your indulgence, I know have you heard me say this time and time again, but I will not sit idly and just listen to rhetoric which is not at all based on the facts that are before us. $890 billion in additional spending was proposed by the other party. They have the right to do so. Thank God, they have the right to do so. But then don't tell us that they are the ones that are concerned about the deficit.

Thank you, Mr. Chairman.

Chairman NUSSLE. Mr. Scott.

Mr. SCOTT. Thank you, Mr. Chairman. I would like to ask unanimous consent that the Joint Committee on Taxation scoring on the Republican tax bill be entered into the record.

Chairman NUSSLE. Is there objection? Without objection so ordered.

[The information referred to follows:]

HOUSE OF REPRESENTATIVES,
May 08, 2003.

MACROECONOMIC ANALYSIS OF H.R. 2, THE "JOBS AND GROWTH RECONCILIATION TAX ACT OF 2003" PREPARED BY THE STAFF OF THE JOINT COMMITTEE ON TAXATION

The SPEAKER pro tempore. Under a previous order of the House, the gentleman from California (Mr. THOMAS) is recognized for 5 minutes.

Mr. THOMAS. Mr. Speaker, pursuant to clause 3 (h)(2)(A)(iii) of rule XIII, I submitted the following macroeconomic impact analysis:

In accordance with House Rule XIII.3(h)(2), this document, prepared by the staff of the Joint Committee on Taxation ("Joint Committee staff"), provides a macroeconomic analysis of H.R. 2, the "Jobs and Growth Reconciliation Tax Act of 2003." The analysis presents the results of simulating the changes contained in H.R. 2 under three economic models of the economy. The models employ a variety of assumptions regarding Federal fiscal policy, monetary policy, and behavioral responses to the proposed changes in law.

1. DESCRIPTION OF MODELS AND RESULTS FORMAT

(A) Models

The Macroeconomic Equilibrium Growth ("MEG") model.—This model, developed by the Joint Committee staff, is based on the standard, neoclassical assumption that the amount of output is determined by the availability of labor and capital, and in the long run, prices adjust so that demand equals supply. This feature of MEG is comparable to a Solow growth model, described as the "textbook growth model" by the Congressional Budget Office (An Analysis of the President's Budgetary Proposals for Fiscal Year 2004, March 2003, pp. 28–29) ("CBO"). Individuals are assumed to make decisions based on observed characteristics of the economy, including current period wages, prices, interest rates, tax rates, and government spending levels. Because individuals do not anticipate changes in the economy or government finances, this type of behavior is referred to as "myopic behavior." Consumption in MEG is determined according to the life-cycle theory, which implies that individuals attempt to even out their consumption patterns during their lifetimes.

MEG differs from a simple neoclassical growth model in that prices in MEG adjust to equilibrate supply and demand with a delay or lag, rather than instantaneously. This feature allows the model to simulate a disequilibrium adjustment path, in which resources may be underemployed or over-employed (used at an unsustainable rate) in response to policies that stimulate or depress economic activity. It also allows an analysis of the effects of differing intervention policies by the Federal Reserve Board. In this respect, the MEG model resembles econometric models such as the Macroeconomic Advisers model and the Global Insight model.

In the MEG simulations in each of the tables below, it is assumed that the Federal Reserve Board either acts aggressively by raising interest rates to counteract almost completely any demand stimulus provided by H.R. 2 ("MEG aggressive Fed response"), or remains neutral with respect to any changes in fiscal policy, allowing temporary changes in demand to affect levels of employment and output ("MEG neutral Fed response").

The Global Insight ("GI") econometric model.—Like the MEG model, this commercially available model is capable of simulating disequilibrium adjustments to changes in demand. The model is made up of a set of equations that estimate from historical data the behavioral coefficients that determine the timing and strength of economic relationships within the model. Comparable parameters in the MEG and OLG models are derived from economic research. In many cases this research is also based on econometric analysis of historical data.

Individuals and firms behave myopically in the GI model. For this analysis, the Joint Committee staff uses an estimated monetary reaction function designed to moderate gradually, but not completely offset, deviations from full employment by lowering or increasing interest rates. Thus, if the economy is operating near capac-

ity, proposals that increase employment and accelerate the economy will result in increasing interest rates.

The overlapping generations life cycle model ("OLG").—In this model, individuals are assumed to make consumption and labor supply decisions with perfect foresight of economic conditions, such as wages, prices, interest rates, tax rates, and government spending, over their lifetimes. The OLG model is similar to the type of model described as a "life cycle model" by the CBO, ibid.

One result of the perfect foresight assumption is that if a policy results in an economically unstable outcome, such as increasing government deficits indefinitely into the future, the model will not solve. Therefore, to run simulations in this model, it is necessary to assume that an offsetting budget balancing fiscal policy will be enacted. In the tables below, it is assumed that either government spending will be reduced after 2013 to offset the tax cut ("OLG future government spending offset") or individual income tax rates will be increased after 2013 ("OLG future tax rate increase").

The cut in government spending to offset the costs of a tax cut can be modeled either as a cut in transfer payments, as is presented here, or as a cut in "non-productive government spending." The latter assumption is used in CBO, ibid. The difference between the two approaches is that consumers are assumed to value transfer payments, and thus work and save more within the budget window in anticipation of losing them; but they are assumed not to value non-productive spending, and therefore do not increase work or savings in anticipation of this cut. Thus, the anticipation of valued spending cuts results in more growth in the early years than the anticipation of non-valued spending cuts.

(B) Results format

Because the exact time path of the economy's adjustment to changes such as a new tax policy is highly uncertain, the Joint Committee staff presents results as percent changes during the Congressional budgeting time frame. In addition, for the MEG and OLG models, which have been designed to provide long-run equilibrium results, information is provided about the long run. While it is impossible to incorporate unknowable intervening circumstances, such as major resource or technological discoveries or shortages, these models are designed to predict the long-run effects of policy changes, assuming other, unpredictable influences are held constant.

Because the MED model is myopic, if the policy simulated is ultimately a fiscally unstable policy, such as a net decrease in taxes that produces deficits that grow faster than the rate of growth of the economy, "long-run" is defined as the last period before the model fails to solve because of this unstable situation. For the OLG simulations, which incorporate a stabilizing fiscal policy offset, "long-run" is defined as the eventual steady-state solution.

2. ESTIMATED MACROECONOMIC EFFECTS OF H.R. 2

The magnitude of the macroeconomic effects generated by these simulations depends upon a number of assumptions, some of which are described above, that are inherent in the models used. Several additional assumptions detailed below.

(A) Assumptions

Effect of tax rate reductions on investment.—Reductions in marginal tax rates (tax rates on the last dollar of income earned) on interest, dividend, or capital gains income create incentives for individuals to save and invest a larger share of their income, as each additional dollar of investment yields more after-tax income. Conversely, reductions in the average tax rate on income from capital provide taxpayers with more after-tax income for the same amount of investment, reducing their incentive to save and invest. Changes in the statutory tax rate affect both marginal and average rates of tax on these sources of income, providing potentially offsetting incentives. Consistent with existing research, the model simulations assume that on net, the marginal rate effect is slightly larger than the average rate effect, and thus decreases in tax rates on capital income increase savings.

Effect of reductions in the dividend tax rate.—There is general agreement that dividend taxation reduces the return on investments financed with new share issues. However, there are two alternative views regarding the effect of dividend taxation on corporate investment returns financed with retained earnings. The "traditional view" holds that reductions in dividend taxes would lower the cost of corporate investment financed with either new share issues or retained earnings, and thus would provide an incentive for corporations to increase investment. Alternatively, the "new view," holds that a reduction in the dividend tax rate would not lower the cost of corporate investment financed with retained earnings. Under this

view, a decrease in the dividend tax rate would result in an immediate increase in the value of outstanding stock reflecting the reduction in dividend tax payments, thus increasing the wealth of the stockholders, and providing an incentive for additional consumption. The model simulations assume that half of the corporate sector is in accordance with the traditional view and half with the new view.

Foreign investment flows.—Increased Federal Government budget deficits increase the amount of borrowing by the Federal Government. Unless individuals increase their savings enough to finance completely the increased deficit, the increase in government borrowing will reduce the amount of domestic capital available to finance private investment. This effect is often referred to as the "crowding out" of private business activity by Federal Government activity. A reduction in national saving may lead to a reduction in domestic investment, and domestic capital formation, depending on the mobility of international capital flows. The government and private firms would compete for the supply of available funds and interest rates would rise to equate the demand and supply of funds. Returns on foreign investments would accure mainly to foreigners and would only increase the resources available to Americans to the extent that higher domestic investment resulted in higher wages in the United States. The MEG and GI simulations incorporate an assumption that there would be some in-flow of foreign capital to the extent that the rate of return on capital is increased by the tax policy. However, the inflow in foreign capital is not enough to offset completely the increased Federal borrowing. The OLG simulations assume there is no inflow of foreign capital.

Effect of tax rate reductions on labor supply.—As in the case of savings responses, tax rate reductions provide offsetting labor supply incentives. Reductions in the marginal tax rate on earnings create an incentive to work more because taxpayers get to keep more of each dollar earned, making each additional hour of work more valuable; while reductions in the average tax rate create an incentive to work less, because they result in taxpayers having more after-tax income at their disposal for a given amount of work.

Consistent with existing research, the simulations assume that taxpayers in different financial positions respond differently to these incentives. Typically, the largest response comes from secondary workers (individuals whose wages make a smaller contribution to household income than the primary earner in the household) and other underemployed individuals entering the labor market. As described above, labor supply responses are modeled separately for four different groups in MEG: low income primary earners, other primary earners, low income secondary earners, and other secondary earners.

Effects of reductions in tax liability on demand.—Generally, any net reduction in taxes results in taxpayers making more purchases because they have more take-home income at their disposal. Policies that increase incentives for taxpayers to spend their income rather than save it provide a bigger market for the output of businesses. The amount of economic stimulus resulting from demand side incentives depends on whether the economy has excess capacity at the time of enactment of the policy, and on how the Federal Reserve Board reacts to the policy. If the economy is already producing near capacity, demand-side policies may, instead, result in inflation, as consumers bid up prices to compete for a fixed amount of output. If the Federal Reserve Board believes there is a risk that the policy will result in inflation, it may raise interest rates to discourage consumption. In this case, depending on how strongly the Federal Reserve Board reacts, little, if any increase in spending will occur as a result of would-be stimulative tax policy. The MEG aggressive Fed response simulation assumes the Federal Reserve Board completely counteracts demand stimulus; the MEG neutral Fed response simulation assumes the Federal Reserve Board ignores the stimulus; and the GI simulation assumes the Federal Reserve Board partially counteracts demand stimulus. The OLG simulations have no monetary sector because they assume demand automatically adjusts to supply through market forces.

(B) Simulation results

Economic Growth.——

TABLE 1.—EFFECTS ON NOMINAL GROSS DOMESTIC PRODUCT

[Percent change in nominal GDP]

	Calendar years	
	2003–08	2009–13
Neoclassical Growth Model:		
MEG—aggressive Fed reaction	0.3	0.2
MEG—neutral Fed reaction	0.9	1.0
Econometric Model:		
GI Fed Taylor reaction function	1.5	1.2
Life Cycle Model With Forward Looking Behavior:		
OLG Reduced Government Spending in 2014	n.a.	n.a.
OLG Increased Taxes in 2014	n.a.	n.a.

TABLE 2.—EFFECTS ON REAL GROSS DOMESTIC PRODUCT

[Percent change in nominal GDP]

	Calendar years	
	2003–08	2009–13
Neoclassical Growth Model:		
MEG—aggressive Fed reaction	0.2	−0.1
MEG—neutral Fed reaction	0.3	0.0
Econometric Model:		
GI Fed Taylor reaction function	0.9	−0.1
Life Cycle Model With Forward Looking Behavior:		
OLG Reduced Government Spending in 2014	0.2	−0.1
OLG Increased Taxes in 2014	0.2	−0.2

As shown in Table 1, depending on the assumed Federal Reserve Board reaction to the policy, the estimated change in Gross Domestic Product ("GDP") due to this proposal can range at least from a 0.3 percent (an average of $43 billion) to a 1.5 percent (an average of $183 billion) increase in nominal, or current dollar GDP over the first 5 years, and 0.2 percent to a 1.2 percent increase over the second 5 years. As shown on Table 2, depending on the assumed Federal Reserve Board reaction to the policy, and on how much taxpayers anticipate and plan for the effects of future Federal Government deficits, the change in real (inflation-adjusted) GDP due to those proposal can range from a 0.2 percent (an average of $18 billion per year) to a 0.9 percent (an average of $76 billion per year) increase in real GDP over the first 5 years, with a small decrease over the second 5 years.

Investment.——

TABLE 3.—EFFECTS ON CAPITAL STOCK

	Calendar years	
	2003–08	2009–13
Percent Change in Non-Residential Capital Stock		
Neoclassical Growth Model:.		
MEG—aggressive Fed reaction	0.6	0.4
MEG—neutral Fed reaction	0.8	0.6
Econometric Model:.		
GI Fed Taylor reaction function	1.5	0.4
Life Cycle Model With Forward Looking Behavior:.		
OLG Reduced Government Spending in 2014	0.1	−0.7
OLG Increased Taxes in 2014	0.1	−0.8
Percent Change in Residential Housing Stock		
Neoclassical Growth Model:.		
MEG—aggressive Fed reaction	−1.0	−1.5
MEG—neutral Fed reaction	−0.8	−1.1
Econometric Model:.		
GI Fed Taylor reaction function	−0.5	−1.3
Life Cycle Model With Forward Looking Behavior:.		

TABLE 3.—EFFECTS ON CAPITAL STOCK—Continued

	Calendar years	
	2003–08	2009–13
OLG Reduced Government Spending in 2014	−0.2	−0.1
OLG Increased Taxes in 2014	−0.2	−0.1

As the results in Table 3 indicate, this policy may increase investment in nonresidential capital in the first 5 years by 0.1 percent to 1.5 percent, while reducing investment in residential capital by −0.2 percent to −1.0 percent because of the reduced cost of capital, which is due to the reduction in taxation of dividends and capital gains, and the temporary bonus depreciation. The investment incentives for producers' equipment in this proposal are likely to shift some investment from housing to other capital. The size of the shift differs between the simulations because of different assumptions about adjustment costs and savings responses. In the second 5 years, the sunset of the bonus depreciation provision, combined with the negative effects of crowding out will slow increases in private nonresidential investment. The simulations indicate that eventually the effects of the increasing deficit will outweigh the positive effects of the tax policy, and the build up of private nonresidential capital stock will likely decline.

Labor Supply and Employment.——

TABLE 4.—EFFECTS ON EMPLOYMENT PERCENT CHANGE IN EMPLOYMENT

	Calendar years	
	2003–08	2009–13
Neoclassical Growth Model:		
MEG—aggressive Fed reaction	0.2	0.0
MEG—neutral Fed reaction	0.4	−0.1
Econometric Model:		
GI Fed Taylor reaction function	0.8	−0.4
Life Cycle Model With Forward Looking Behavior:		
OLG Reduced Government Spending in 2014	0.2	−0.1
OLG Increased Taxes in 2014	0.2	−0.1

As shown in Table 4, employment may increase from 0.2 percent (approximately 230,000 new jobs) to 0.8 percent (about 900,000 new jobs) in the first 5 years, as the effects of the acceleration of individual rate cuts, and the initial increase in investment prevail. Employment increases in the first 5 years because of both the positive labor supply incentive from the individual rate cuts, and the economic stimulus effect of the proposal taken as a whole. This increase disappears by the end of the budget period, ranging from 0 percent to −0.4 percent. The acceleration of the individual tax rate reductions is effectively a temporary provision relative to present law; thus, the positive labor supply incentives are temporary.

A substantial portion of the tax cuts in the proposed growth package, those attributable to the acceleration of the individual income tax provisions in the Economic Growth and Tax Relief Reconciliation Act of 2001 ("EGTRRA"), and the bonus depreciation/NOL carryback combination are temporary (operating from 2003–2006), and therefore likely to result in modest demand stimulus primarily in the first 5 years in the myopic models. In the OLG stimulations, in which individuals foresee the temporary nature of the stimulus, the increase in consumption is spread across both periods.

3. BUDGETARY EFFECTS

When the macroeconomic effects of a change in tax policy are taken into account, estimates of the change in receipts due to the proposal may change. To the extent that a new policy changes the rate of growth of the economy, it is likely to change the amount of taxable income, which will have a "feedback effect" on receipts. In addition, by increasing the after-tax return on investments in capital that generate taxable income, a change in policy may shift investment from non-taxable or tax-favored sectors, such as the owner-occupied housing market, into the taxable sector, and thereby increase receipts. The model simulations indicate that the policy analyzed here is likely to result in more economic growth in the first 5 years than under current law, and hence results in less revenue loss than what is predicted using con-

ventional revenue estimates. As the GDP growth declines in years 6–10, the revenue feedback also declines.

A change in policy, however, may result in inflation as well as real economic growth. Inflation causes increases in nominal revenues (revenues measured in current dollars), without necessarily increasing the purchasing power of the Federal Government. Conventional budget analysis is conducted in nominal dollars. To the extent that this analysis applies equally to revenue and expenditure estimates, this practice provides a reasonably accurate picture of the effects of inflation on the Federal budget. However, the Joint Committee staff analyzes the effects of tax policy on receipts, but not spending. Reporting revenues due to inflation, without reporting the commensurate budget effects would present an inaccurate picture of the effects of the proposal on the entire deficit. Therefore, the Joint Committee staff provides budgetary analysis in real (inflation-adjusted), rather than nominal terms. Table 5 shows the percent revenue feedback relative to the conventional revenue estimate, in real terms.

Even when presented in real terms, revenue feedback analysis alone may provide an incomplete picture of the effects of tax policy on the Federal budget. To the extent that the policy results in a net decrease in Federal receipts, with no offsetting expenditure reductions, the policy results in an increase in the Federal deficit. Increases in the Federal deficit generate additional debt service costs.

To determine how changes in tax policy affect the ability of the government to meet its current and future obligations it is helpful to compare tax-induced changes in the deficit and GDP. If GDP is growing faster than the deficit, the fiscal situation is improving, whereas if the deficit is growing faster, the fiscal situation is worsening. If deficits are growing faster (slower) than GDP, then the ratio of Federal debt to GDP would increase (decrease), which implies that future generations would have less (more) income to consume and invest after making payments on the debt.

TABLE 5.—EFFECTS ON REAL REVENUES PERCENT FEEDBACK IN REAL REVENUES RELATIVE TO REAL CONVENTIONAL ESTIMATE

	Calendar years	
	2003–08	2009–13
Neoclassical Growth Model:		
MEG—aggressive Fed reaction	9.8	3.6
MEG—neutral Fed reaction	27.5	23.4
Econometric Model:		
GI Fed Taylor reaction function	16.1	11.8
Life Cycle Model With Forward Looking Behavior:		
OLG Reduced Government Spending in 2014	6.1	3.0
OLG Increased Taxes in 2014	5.8	2.6

Table 5 shows the relationship between the change in receipts generated using macroeconomic analysis, and the predicted change in receipts provided by a conventional revenue estimate. A positive percentage indicates the estimated revenue loss is less when macroeconomic effects are taken into account than when estimated using conventional methods. As the simulations indicate, depending on how much temporary demand stimulus is generated by the proposal, the revenue feedback could range from 5.8 percent to 27.5 percent in the first 5 years, and 2.6 percent to 23.4 percent over the 10-year budget period.

4. DATA SOURCES

All of the macroeconomic models used by the Joint Committee staff are based primarily on quarterly National Income and Product Account ("NIPA") data published by the Bureau of Economic Analysis, U.S. Department of Commerce. In the MEG model, and to the extent possible in the commercial models, Joint Committee staff use the forecast for Federal and State and local government expenditures and receipts forecast by the Congressional Budget Office (The Budget and Economic Outlook: Fiscal Years 2004–2013, January 2003) instead of the NIPA series for these fiscal variables. For purposes of modeling changes in average and marginal tax rates in the macroeconomic models, the Joint Committee staff use microsimulation models that are based on tax return data provided by the Statistics of Income Division of the Internal Revenue Service ("SOI").

The Joint Committee staff uses these microsimulation models to determine average tax rates and average marginal tax rates for the different sources of income in each model, and to calculate the changes in these rates due to the proposal. The

tax calculator calculates the change in liability due to the proposal for each record. These changes are aggregated for use in the macroeconomic models according to the different levels of disaggregation in each model. In the aggregations, averages are weighted by the income for each group. The percent change in average and marginal rates due to this proposal are:

TABLE 6.—PERCENT CHANGE IN TAX RATES DUE TO PROPOSAL

Year	Average tax rate on wages	Average marginal tax rate on			
		Wages	Interest	Dividends	Capital gains
2003	−11	−9	−11	−51	−24
2004	−10	−6	−8	−49	−23
2005	−9	−3	−6	−52	−24
2006	0	0	0	−48	−23
2007	−1	0	0	−48	−23
2008	0	0	0	−50	−22
2009	−1	0	0	−47	−22
2010	−1	0	0	−48	−22
2011	−1	0	0	−52	−22
2012	−1	0	0	−50	−21
2013	0	0	0	0	0

To obtain information about the effects of proposals affecting business tax liability, the Joint Committee staff uses a corporate tax microsimulation model that is similar in structure to the individual tax model. This data source for the corporate model is a sample of approximately 140,000 corporate tax returns provided by SOI.

Depending on the requirements of the policy simulation, the corporate model can be run either on a full cross section of sampled tax returns, (i.e., one full year, or on a panel of returns constructed from any combination of tax years in the 1987 through 1998 period). This panel feature is particularly useful in tracking net operating losses and credits that can be either carried back or carried forward to other tax years.

Finally, Joint Committee microsimulation tax calculators are also used to help assess the effect of a tax proposal on the cost of capital because some firms are operating at or near a net operating loss ("NOL") position, not all of the 50 percent of equipment expenses can be deducted by each firm each year. A key component of the cost of capital is the net present value of depreciation deductions. An increase in the value of the depreciation deduction lowers the cost of capital. The calculated percent increases in the net present value of the depreciation deduction due to this proposal are shown below (the change is different for each of the first 3 years because of the temporary nature of the bonus depreciation provisions in present law and in the proposal):

TABLE 7.—EFFECTS ON NET PRESENT VALUE OF DEPRECIATION DEDUCTION

Year	Percent change from present law
2003	8.3
2004	9.1
2005	15.4
2006	.005

5. CONCLUSION

The Joint Committee staff model simulations indicate that H.R. 2 would likely stimulate the economy immediately after enactment by creating temporary incentives to increase work effort, business investment, and consumption. This stimulus is reduced over time because the consumption, labor, and investment incentives are temporary, and because the positive business investment incentives arising from the tax policy are eventually likely to be outweighted by the reduction in national savings due to increasing Federal Government deficits.

Mr. SCOTT. Thank you.

The first question to the witness is you mentioned the recession, when did the recession begin?

Mr. BOLTEN. NBER, which is the official recession declarer, has put it some time ago, put it at March of 2001. Other economists have actually put it some months earlier.

Mr. SCOTT. March 2001.

Mr. BOLTEN. Yes.

Mr. SCOTT. OK.

Mr. BOLTEN. They generally do not go back and revise their estimates. Other economists have gone back and done revisions and put the beginning of the recession earlier.

Mr. SCOTT. You mentioned that the tax cut was a small portion of the deficit. What is the amount of the 10-year tax cut? What is the amount of money that is involved in that?

Mr. BOLTEN. I don't have that off the top of my head.

Mr. SCOTT. Ten years worth of tax cuts? What is the 10-year deficit?

Mr. BOLTEN. Mr. Scott, we projected for this mid-session review. We projected only out over a 5-year window.

Mr. SCOTT. OK. One of the things that we are concerned about is how bad things would have to get before you acknowledge that somebody doesn't know what they are talking about. We have heard percentages of the debt compared to the GDP. I would like to kind of get an idea of how much of our annual budget is paid for with annual revenue and how much is paid for with borrowed money on a percentage basis.

Mr. BOLTEN. I would like to provide that for the record, Mr. Scott. That is something else I don't know off the top of my head.

[The information referred to follows:]

MR. BOLTEN'S RESPONSE TO MR. SCOTT'S QUESTION REGARDING ANNUAL REVENUE

Approximately one-fifth of the 2003 and 2004 budgets are estimated to be financed by borrowing. By 2008, we estimate that the share of the budget financed by borrowing will fall to 8 percent. Attached is a table that shows our estimates of the portion of the budget to be financed by borrowing each year through 2008.

FISCAL YEAR 2004 MID-SESSION POLICY

[In billions of dollars]

	Actual 2002	Estimate					
		2003	2004	2005	2006	2007	2008
Total budget outlays	2,011	2,212	2,272	2,338	2,452	2,573	2,706
Paid for with annual revenue	1,853	1,756	1,797	2,033	2,215	2,360	2,480
Paid for with borrowing from the public (net of financing other than the change in debt held by the public)	158	455	475	304	238	213	226
Percent of total budget outlays:							
Paid for with annual revenue	92%	79%	79%	87%	90%	92%	92%
Paid for with borrowing from the public	8%	21%	21%	13%	10%	8%	8%
Total	100%	100%	100%	100%	100%	100%	100%

Mr. SCOTT. OK. To get the—let me just point out the chart that we are looking at up here. The comments have been made about what the Democratic plan is and what the Republican plan is. This charge separates the rhetoric from the reality. Democrats voted for the green, Republicans voted for the red. That is the deficit. Democrats voted for the green; we moved the deficit into surplus. Repub-

licans voted for the red, and that is the deficit. To get the budget back in balance, what percentage would we have to increase the income tax, individual income tax?

Mr. BOLTEN. Mr. Scott, my first answer is I don't know. My second answer is that I think that would be the worst thing to do, to restore the budget to balance. We could, in fact, increase taxes this year in an amount that would be equivalent to the deficit, but that would have such a detrimental effect on the economy that we would find ourselves in a much worse situation.

Mr. SCOTT. I agree with you 100 percent. It took 8 years to dig us out from a $290 billion deficit, 8 years of hard, difficult choices, politically unpopular choices, but that's the green. Now, we are worse than that. So you are right. It would probably take a long time. But my question was whether or not we are even going in the right direction. We have—we have been told that we need to cut spending. How much, what portion of nondefense discretionary spending would we have to cut in order to balance the budget?

Mr. BOLTEN. Oh, in 1 year, we would probably have to eliminate nondefense discretionary spending to balance the budget in 1 year. But that is not the——

Mr. SCOTT. Wait a minute. Say that again.

Mr. BOLTEN. We would probably have to eliminate nondefense discretionary spending if you tried to balance the budget in 1 year.

Mr. SCOTT. Are you saying insofar of deficit right now, that elimination of all nondefense discretionary spending would not bring the budget into balance, is that what you just said? I mean, it is true, I just want to get to you say it again.

Mr. BOLTEN. Mr. Scott, I am happy to say it again, because that is clearly not the right sort of prescription.

Mr. SCOTT. To eliminate all nondefense discretionary spending, eliminate it all, is not the right thing to do. But we have been told the problem with the budget is spending.

Mr. BOLTEN. No, sir. You may have missed most of my testimony, but——

Mr. SCOTT. I am sorry, I was listening to the President, so maybe I should have been listening to you.

Mr. BOLTEN. You were spending your time much more wisely, sir. But what I did say was that that the principal cause that brought us into the deficit situation we are in now is economic growth that has flagged well below the projected levels. So the important thing we need to do while we exercise spending restraints is ensure that we return to a growing economy which is precisely what the tax cuts that have been enacted by this Congress over the last two and a half years have been designed to do.

Mr. SCOTT. It hasn't worked; is that right?

Mr. BOLTEN. I think it is, actually.

Mr. SCOTT. How much worse would it to have to get before we figure out that it is doesn't work?

Mr. BOLTEN. Well, I think——

Mr. SCOTT. Can you put the chart back up there. How much worse would it have to get before we figured out it didn't work?

Mr. BOLTEN [continuing.] Mr. Scott, I think the situation would actually be a great deal worse today in the absence of the tax cuts that this Congress has enacted.

Chairman NUSSLE. Let me announce to my colleagues, we have votes that will occur in about 20 minutes. And just by perfect happenstance, we have just the perfect amount of members who have not asked questions. So this will work out very well. Mr. Hensarling.

Mr. HENSARLING. Thank you, Mr. Chairman. Forgive me, Mr. Bolten, but I am one of the members who did miss your testimony. I too am a freshman and have yet to master the art of being at three places at once. So if some these questions are redundant, please forgive me. Like my good friend from Florida, Mr. Diaz-Balart, occasionally, I may be mathematically challenged. I have heard a lot of questions concerning the tax relief that we have voted on in the budget. But if I am doing my math correctly, we voted on a $350 billion tax relief growth package out of a 10-year, $28.3 trillion budget. If I am doing the math right, that is about 1.2 percent is the growth package which would tend to suggest to me that almost 99 percent of the deficit problem that we are facing now is on the spending side. Can you tell me if I did the math right there?

Mr. BOLTEN. You are correct that as a percentage of the economy, the $350 billion tax cut does come to 1.something percent.

Mr. HENSARLING. So everything that we seemingly hear on this side of the aisle is focusing on 1.2 percent of the problem and essentially ignoring 99 percent of the problem? Let me also ask because people question the growth package tax reliefs' impact on economic growth. Can you tell me what percentage of the tax relief that we have passed has actually made its way into the economy, into the hands of families, into the hands of small businesses?

Mr. BOLTEN. I am advised, Mr. Hensarling, that we had $45 billion in fiscal year 2003, and projecting $152 billion in calendar year 2004.

Mr. HENSARLING. So out of the entire growth package, we have still had a relatively small percentage that has worked its way through the economy?

Mr. BOLTEN. I wouldn't say small, but it is—there is still quite a bit to come. The only thing I would say about it is the package was crafted to get the money into the economy about as rapidly as it physically could be done, and we will see in a few weeks when checks start going out to families with children.

Mr. HENSARLING. I am one member, I believe we all share this concern, I believe the deficit is a major problem. However, I tend to be more concerned at the absolute amount of money that we spend around here. The deficit is simply spending on a credit card as opposed to paying cash. To me what is most salient is how much money are we taking away from American families to pay for the government that we have now. Seems to me that logically there are several ways that we can reduce this deficit. Obviously, we hear from our friends on this side of the aisle that we need to raise taxes to close the deficit. I believe our paramount responsibility ought to be to promote economic growth which is one of the reasons I supported the President's package. And indeed, history does tell us that tax relief can promote economic growth.

It also seems to me that there is a lot of waste and a lot of fraud in Washington government and we spend too much time here, I be-

lieve, in deciding how much more money will we throw at a problem as opposed to what are we getting for our money. To me it is not a matter of how much money Washington spends, it is how Washington spends the money.

For example, we have had testimony before this committee before that $13.3 billion of improper payments were made in Medicare. If you straight line a $400 billion prescription drug benefit package over 10 years, bottom line is we just threw away a third of the cost of the prescription drug program.

My question is does the administration believe that there are opportunities within this budget to find savings without cutting vital government services?

Mr. BOLTEN. We absolutely do, Mr. Hensarling, and Chairman Nussle has been a leader in pushing toward the retrieval of erroneous payments. We are working hard on that within OMB and within the rest of the President's administration.

Mr. HENSARLING. I yield back the balance of my time.

Chairman NUSSLE. Mr. Moran.

Mr. MORAN. Let me wrap up with some points. These are not new points to any of us on the Budget Committee. Some of them may be new to you, although I doubt it. Just for the public's edification, I would like to put up chart 8, it is one that Mr. Scott is also fond of, just to give you a sense of what you have to deal with. It is a pretty dramatic chart. Page 8, I am sure—there is the one.

It shows that one fiscal policy approach worked beginning in 1993 when President Clinton took office and another has been a dismal failure at least if you look only at the facts rather than ideology, and that is what happened beginning in 2001. Your administration inherited a $5.6 trillion surplus. It is gone, plus trillions of dollars in addition to that. And you know, we have heard so many times from my friends on the other side of the aisle about the need to cut taxes, but really what President Clinton did was to build on a policy that the first President Bush began in 1990 of trying to balance the budget first. And by doing so, he put in motion something that worked that balanced the budget and in fact we have the strongest economic growth we ever had. And those people who would have benefited—those people who paid the most in increased taxes brought home the most after tax income after there were marginal incremental increases in their tax rate. And that is what economic growth can do for you.

Now what we have done here is to create a climate of deficits as far as the eye can see. And our concern is not only with the tax cuts that have already been enacted, but in your mid-session review on page 50 you plan for another $878 billion of additional tax cuts over the next 10 years. Now that is on top of, as Mr. Spratt pointed out, tax cuts of $3.7 trillion.

Now you disagree with that, but on the other hand, you don't disagree, I am sure, that the Congress is going to make permanent all of the tax cuts that have been enacted today. If you make those permanent, as I know the White House is going to urge us to do, and you have included the interest, which any good accountant or budget officer would do, is $3.7 trillion, almost identical to the amount of a unified deficit. And in fact, over 2003–04, the reality is that spending all of the Social Security Medicare Trust Fund

surplus would be insufficient to meet the deficit to balance the budget even if we spend nothing on defense and homeland security, which we are not going to do, and that is Mr. Scott's point.

You know, we keep hearing on the other side of the aisle about the need to eliminate waste, fraud and abuse. While we had people testify, what was it, last week, from the major agencies, none of them agree that these numbers are realistic. Then we talk about increased spending and it always goes down to social programs. If we eliminate all the social programs we are not going to balance the budget. But the worst problem we have is what we are doing to this country because not only are we going to be cutting and slashing social programs, but it is the unequal distribution of these tax cuts. Warren Buffett has perhaps articulated it best. He said this is a class war but my class has won. I am going to get hundreds of millions of dollars benefit from these tax cuts. I am going to wind up with an effective tax rate of 3 percent, and my secretary is paying an effective tax rate of 30 percent. How is that fair to have one-tenth of the wealthiest people in this country get as much benefit as the bottom 90 percent?

In other words, 90 percent of people may have incomes of $95,000 or less per year. In total their tax benefit is as much as the top one-tenth of 1 percent. And that is what I think is going to erode the real economic strength of this country. The top 1 percent own 43 percent of the wealth in this country. That has gone up dramatically and is going to go up more dramatically with your tax cuts.

And you know, if you don't agree with those facts, then I would love to hear you say so, but that is what we are faced with and that is why we are so frustrated, and that is why we wish you the best but we sure aren't optimistic about the results of your tenure any more than we are with Mr. Daniels'.

Mr. BOLTEN. Thank you, Mr. Moran, for making me feel welcome.

Mr. MORAN. Well, I am sure you are nice guy. We have a responsibility beyond—you are probably a constituent, too. I always run that risk.

Chairman NUSSLE. There goes another vote.

Mr. MORAN. I have already ticked off most of them. I might as well do it to Mr. Bolten. Welcome aboard, Mr. Bolten.

Chairman NUSSLE. If the witness would care to respond, and then we do have votes that are going to be coming here very soon.

Mr. BOLTEN. Mr. Moran, I appreciate the spirit of your remarks. I do disagree with many of your views on the facts. If I can get one chart up in particular, it is our chart on upper income share of the tax burden. This is how the three tax cuts that have been enacted in the last two-and-a-half years play out in terms of the share overall tax receipts that people pay. Those that make more than $100,000 before these three tax cuts paid 70 percent of all tax receipts. They now pay over 73 percent of all tax receipts. They—further on the numbers and size of the overall cost of the tax cut, our numbers come out very different, less than half of the ones you do. I think we can probably get together, and hopefully in a congenial environment, and try to reconcile some of those numbers.

But let me go to the broader picture, because there is one point that you made that I agree with very strongly, and I do this without any intent to point fingers one way or the other. But the President did not inherit a $5.6 trillion surplus. The President inherited an economy headed into recession and headed fairly sharply into recession. And the budget picture was not nearly as rosy as the one that was projected before the President came into office. The President inherited a very weak economy. Then he had to deal with corporate scandals that had been brewing for many years, with the September 11 attacks, with the war in Afghanistan and Iraq. All of these things combined made for a very different situation than the one we came in on.

But the point I agree with you very strongly on is that the strong economic growth that we saw through certainly the latter part of the 1990s is the key to our budget situation, and that is why our focus is on restoring the economy to that kind of strong growth. And our perspective is that the best way to get back to that growth is through the effective implementation of the tax cuts that have been enacted so far.

Mr. MORAN. Fifteen seconds. That is income taxes. It isn't estate taxes or other taxes. I know you would agree.

The other reason why our number is different, you know as well as I do that we are going to make permanent all of those tax cuts, at least if the composition of the Congress remains majority Republican. And that is why I think our numbers are somewhat more valid than the projections you have here, but I don't want to be argumentative any more than I have been, and I appreciate your response, and thank you, Mr. Chairman.

Chairman NUSSLE. Mr. Portman.

Mr. PORTMAN. Thank you, Mr. Chairman. And I want to welcome our witness as well. At the outset Mr. Spratt has said that his reputation precedes him and followed that by saying it is a good reputation, and it is. It is of being bright, capable and, most important to me and this committee, to have a personal commitment to good public policy. And there has been a lot of political rhetoric back and forth today. I wasn't here for all of it, but I have heard some of it and I appreciate your response to the last query. But in general, we are delighted that you are in a position you are in because we all have a challenge ahead of us.

And I will say briefly in response to my friend Mr. Moran when you add up everything, including the estate tax, the top income taxpayers in this country will pay a bigger part of the burden than they do now after all the Bush tax cuts, the 2001 tax cuts, the 2003 economic growth and jobs package, and it is something to keep in mind. The top 1 percent is now paying 37 percent of the taxes. If Warren Buffett wants to pay more that is great. He ought to. But I take my economic advice not from Warren Buffett and others out there who play with money and invest, but the entrepreneurs who are going to create those jobs, and I hope we will keep a focus on that.

I would ask you, Mr. Bolten, if you would comment, which I know is hard for you to do in the White House, on Mr. Greenspan's testimony yesterday and specifically whether you agree with his statement where he said that the $350 billion tax cut package, the

economic growth and jobs package enacted earlier this year, was helpful and his prediction that those tax cuts will provide a considerable lift, which were his words, in the second half of this year to our economy.

Mr. BOLTEN. I do strongly agree with that.

Mr. PORTMAN. Mr. Greenspan is testifying again today in the Senate and I am sure he will reiterate that, but the point that I am trying to make is that these tax relief measures that we put in place are not static. And Mr. Spratt had a chart up earlier, I don't know if I have access to the Democrat charts, indicating that the tax cuts were the cause of the deficit because it compared the tax cuts with our deficit, which takes into account not at all the dynamic impact of these tax cuts, which was true back in the 1960s with John Kennedy. It was true in the 1980s with Ronald Reagan, even true in the 1990s when the Republican Congress convinced President Clinton to put some tax relief in place in addition to the balanced budget agreement.

I will also say that when I was first running for Congress in 1992, guess what, as a percentage of our GDP our deficit was 4.7 percent. Today as a percentage of our GDP our deficit even with these new estimates of, let us say, $460 billion, even exceeding the numbers that CBO has provided us and OMB has provided us, is about 4.2 percent of GDP. And I think that is important to point out because the economists will tell you whether they are right, left or center that it is a percentage of our economy that is really important in terms of the impact on our economy of our deficit.

Is that acceptable? No, it is not. There are two ways to deal with it. One is keeping spending under control and the other is growing the economy, and the tax cuts are going to grow the economy. And to my colleagues on this side of the aisle, are you for cutting spending and, if so, where? I would like to hear. We are trying very hard to keep to our budget that this committee passed on, unfortunately, a partisan basis which does keep spending under control. And second, how do you feel about the tax relief?

I know, Mr. Spratt, you were on Fox News last night and you indicated that you do believe that tax cuts do stimulate the economy, and that is why you voted for the second tax cut. I believe that, too. We may differ on how much and which tax cuts are better or worse. But to say it is static and doesn't have any impact I think is not accurate. And certainly as Mr. Bolten has said, he would agree with Mr. Greenspan's testimony yesterday saying that those tax cuts were helpful in trying to get this economy going again.

Another question I have for you is about jobs. How much impact have the economic growth packages and the tax cut in 2001 had on jobs? What would it be like had those tax cuts not been in place? How many jobs would we have lost?

Mr. BOLTEN. There have been several analyses of that, Mr. Portman. The chairman just highlighted one this morning that showed that the tax cuts saved 1.8 million jobs over the last year or two.

Mr. PORTMAN. Could we put up chart 3 or chart 4? That is the 1.8 million that I saw in our packet.

Mr. BOLTEN. And the Treasury Department yesterday released a study with numbers roughly in the same range.

Mr. PORTMAN. Chart 4 is the unemployment number and it shows that instead of a 7.8 percent unemployment we are talking about unemployment in the 6 percent range if these tax cuts had not been in place. How about the GDP growth? Do you think it is stronger than it would have been without the tax cuts?

Mr. BOLTEN. Yes, absolutely. And the Treasury Department's study released yesterday, I believe, showed GDP 2 percent higher than it otherwise would have been.

Mr. PORTMAN. Two percent higher. Thank you very much again for your testimony today and, more important, what you will do for this committee over the next year to put together a budget for the next fiscal year and working with us to try to get through this deficit.

Chairman NUSSLE. Go to Mr. Spratt for one question, and then Mr. Shays will wrap up our hearing with questions.

Mr. SPRATT. Mr. Bolten, let me ask you to turn to page 39 in your booklet there on summary table No. 7. This shows receipts and outlays as a percentage of GDP. Have you got it?

Mr. BOLTEN. Yes, sir.

Mr. SPRATT. If you look under 2004, next year, when we have the largest deficit in our Nation's history, $475 billion, revenues at that point are also at a historic low, 16 percent of GDP, Gross Domestic Product. That is the lowest level since 1950, 16 percent. In order to get from $475 billion in deficit to about 300 and change in—rather to get to $226 [billion] in 2008, you got to have an increase in the percentage take of the GDP for taxes of 2 full percentage points. Now 2 percent of GDP doesn't sound like a lot, but that chart shows that is 2 percent of $13.671 trillion. That comes to at least $270 billion. So all of the improvement in the deficit from 475 down to 226 is due to this increased amount of revenues stemming from the fact that we have a systemic change, an increase not because the economy is getting better but because the tax system is collecting more. At that point in time by our calculation enacted tax cuts will reduce taxes as a percentage of GDP by 1.7 percent each year. So you are assuming that notwithstanding that reduction, 1.7 percentage points of GDP due to tax cuts, you will still be able to increase the revenue take of GDP by 2 full percentage points. How do you do that? What is the underlying assumption for that significant shift in tax payments over a relatively short period of time?

Mr. BOLTEN. I will let one of the experts perhaps after the hearing go into greater detail with you on this, but I think the estimate is sound for a couple of reasons. First of all, if you will look back at 2002, we did move in just 2 years with a 2 percent drop in the revenues as a percentage of GDP.

Mr. SPRATT. That was before most of the tax cuts were implemented.

Mr. BOLTEN. True, but the really important effect here is not the tax cuts, it is the mix of what the economy and the revenues consist of. What we had in the late 1990s and early part of this decade was a large bubble of Treasury receipts from not just corporate income tax but from high wage earner income tax and from capital

gains. And we saw those just fall off very radically with the collapse in the stock market and with some recovery in the stock market and some substantial growth in the economy. I think these estimates most economists will agree are all within the reasonable range. And there is one additional factor, and that is the bill that you all enacted, the 2003 bill that you enacted, has a bonus depreciation provision which allows companies to write off their depreciation expenses very rapidly in 2003.

Mr. SPRATT. As I understand from your numbers, that is one tax that you are going to cut that you are going to allow to expire.

Mr. BOLTEN. That is correct. We have assumed all taxes extend except for the bonus depreciation which was intended to be short-term and precisely because we wanted to stimulate the investment in the short years, in 2003 and 2004. But the result of that in the numbers is that we see a large drop in revenues in 2003 and 2004 because they are able to write off that amount, but then a substantial recovery in the numbers in 2005 and beyond.

Mr. SPRATT. Mr. Bolten, is that a lesson to be learned? By allowing that tax cut to expire, by repealing one of the substantial tax cuts, you are improving the deficits substantially by 50 percent?

Mr. BOLTEN. The lesson applies exclusively, and I mean exclusively, to accelerated depreciation provisions, which are designed to move investment from one period where it is expected back to another.

Mr. SPRATT. I won't pursue that. I asked you earlier for a 10-year run out of what your estimate of the diminution reduction in the surplus due to economical and technical effects, miscalculation over the 10-year period, 2002–2011 is and if you could give us that for the record I would appreciate it. And secondly, if you could break out the economic and technical effects and explain to us the different elements of each and how much is economic and how much is technical, we would like to have that.

Mr. BOLTEN. To the extent we feel we can provide reliable estimates we will do that.

Chairman NUSSLE. We will go to Mr. Shays to wrap things up.

Mr. SHAYS. Thank you very much, Mr. Chairman. I didn't think the chairman's tie was all that great, so he said I would go last. But I wanted to go last as well because I wanted to hear how my colleagues would respond to your primary point, that $278 billion—the deficit would be $278 billion if there had been no tax cut and that still stands. And the bottom line is there would be a deficit and the reason there would be a deficit, and you pointed out so eloquently of a slowing economy and increased government spending, which fits into the fact that during our time on this committee when we voted out our budget resolution, our Democratic colleagues added $982 billion to our budget resolution, nearly a trillion dollars. And it didn't stop there on the floor of the House.

And if we would put up chart No. 9. And it is interesting when you look at this chart because zero is baseline, so there is even increased spending if no bar went up at all. But the difference between the two packages and our Democratic colleagues added $890 billion to the overall package on the floor, or at least attempted to. Now having said that, if you turn to chart 8—don't put it up yet. Let me just make this point. My first choice and I would think it

would be yours as well is that we would have tax cuts accompanied by restraint in spending. And we did have Alan Greenspan come before our Financial Services Committee and make the point—he urged restraining Federal spending to protect the national fiscal health, but he also acknowledged that the tax cuts were helpful, but he said if it had been accompanied with a restraint in spending it would have done an even better job.

Now my second choice would be tax cuts in a sluggish economy even if not accompanied by a restraint in spending. And the thing that our Democratic colleagues didn't point out in their chart was when we had deficits under their reign, we had deficits when times were good. What would have been the outcome if we hadn't under a Republican Congress restrained spending brought deficits into surpluses? What would the deficits be today had we not done that?

Mr. BOLTEN. I don't have an estimate for you, Mr. Shays, but the numbers would be substantially larger than they are today.

Mr. SHAYS. Clearly they would be off the chart. Let me just ask then, the other reason I was so eager to stay to the end wanting to hear your testimony obviously and all of it and to hear how you responded to the questions, but I would like, Mr. Chairman, to put in the record a request that you made with my—to our colleagues. You requested that if they didn't agree with the tax cuts that they support Mr. Rangel's bill, H.R. 436, to repeal the tax cuts because they were clearly very critical of the tax cuts. And there is no one on the list. And I would like to put on the record the sheet as it is and point out that not one of our Democratic colleagues who said they didn't like the tax cuts were willing to repeal them.

Chairman NUSSLE. Without objection.

[The information referred to follows:]

U.S. House of Representatives

Congress: 108TH
Session: 1ST
Date: 7/16/03

Pursuant to clause 7 of Rule XII of the Rules of the House of Representatives, the following sponsors are hereby added to:

H.R. 436
H.J. Res. _____
H.Con. Res. _____
H.Res. _____

1) _____	21) _____
2) _____	22) _____
3) _____	23) _____
4) _____	24) _____
5) _____	25) _____
6) _____	26) _____
7) _____	27) _____
8) _____	28) _____
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12) _____	32) _____
13) _____	33) _____
14) _____	34) _____
15) _____	35) _____
16) _____	36) _____
17) _____	37) _____
18) _____	38) _____
19) _____	39) _____
20) _____	40) _____

Member Signature: _____

Mr. SHAYS. And let me finally say to you my Democratic colleagues are in an awkward position. They support significant increases in spending but do not acknowledge that ever increasing spending is growing the deficits. And they criticize the tax cuts but do not support reinstating the tax cuts.

And go to the last chart and I will ask you a question in this. My biggest concern is we do have deficits when times are bad. And this is chart No. 8. Even under this Republican Congress, we are seeing a significant increase in spending, not as much as the Democrats would like us to spend. I would like you to comment about that increased spending. I would like you to answer how we are making sure that these deficits don't become institutionalized.

Mr. BOLTEN. Well, first with respect to the spending, I think that underscores the importance of the work of this committee, which I am committed to cooperating in the months ahead of ensuring that we have sound budget resolutions that are enforceable, that ensure that we keep as tight a lid as we possibly can on spending that is not absolutely essential.

Second, the way that we are going to ensure that budget deficits do not become a permanent part of the fiscal scene is principally to ensure that we have an economy that is strong, robust, with plenty of jobs for people who want to work. That is the most important thing we can do. And the tax cuts which the Congress enacted and the President signed over the last two-and-a-half years have been the best measures to ensure that we get back to that economy that will put us on the right path toward budget balance.

Mr. SHAYS. I thank the gentleman and I thank you, Mr. Chairman.

Chairman NUSSLE. Mr. Garrett, since you returned, do you have a quick question? Otherwise—then if there is nothing further to come before the committee, we thank you for your testimony. We welcome your partnership and look forward to working with you. And with that, the committee is adjourned.

[Whereupon, at 12:25 p.m., the committee was adjourned.]

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