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S. HRG. 104—239

THE IMPACT OF PRESIDENT CLINTON'S 10-YEAR BUDGET ON THE ECONOMY

HEARING

before the

JOINT ECONOMIC COMMITTEE CONGRESS OF THE UNITED STATES

ONE HUNDRED FOURTH CONGRESS

FIRST SESSION

June 22, 1995

Printed for the use of the Joint Economic Committee

U.S. GOVERNMENT PRINTING OFFICE
WASHINGTON: 1995

For sale by the U.S. Government Printing Office
Superintendent of Documents, Congressional Sales Office, Washington, DC 20402
ISBN 0-16-052038-X

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[Created pursuant to Sec. 5(a) of Public Law 304, 79th Congress]

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THE IMPACT OF PRESIDENT CLINTON'S 10-YEAR BUDGET ON THE ECONOMY

Thursday, June 22, 1995

CONGRESS OF THE UNITED STATES,
JOINT ECONOMIC COMMITTEE,
WASHINGTON, D.C.

The Committee met at 9:35 a.m., in Room 106 of the Dirksen Senate Office Building, the Honorable Connie Mack, Chairman of the Committee, presiding.

Present: Senators Mack, Grams and Santorum, and Representative Ewing.

Also present: Melissa Cortese, Jeff Givens, Brian Wesbury, Robert Mottice, Andrea Tippett, Lee Price, William Spriggs, Chad Stone, Carrie Weeden, Missy Shorey and Shelley Hymes.

OPENING STATEMENT OF SENATOR CONNIE MACK, CHAIRMAN

Senator Mack. Good morning.

Let me welcome Alice Rivlin, director of the Office of Management and Budget. Let me also welcome everyone else.

Let me begin by saying that I commend the President's decision to join Congress's efforts to achieve a balanced budget. President Clinton's willingness to work toward a balanced budget signals an important shift in the way Washington has dealt with this issue over the last several years.

At long last, both the Legislative and Executive branches appear to share the same goal. For those of us who have been committed to a balanced budget, that scenario is almost too good to be true.

In a few ways it may be. And I'm referring, of course, to the figures upon which the President bases his budget savings.

Two years ago, before a Joint Session of the Congress, President Clinton stressed the significance of using, in his words, and I quote, "the independent numbers of the Congressional Budget Office."

Let's look at what the President had to say.

(A videotape is shown. The transcript follows:)

President Clinton: "The Congressional Budget Office was normally more conservative in what was going to happen and closer to the right than previous presidents have been."

(Applause.)

"I did this so that we could argue about priorities with the same set of numbers. I did this so that no one could say I was estimating my way out of this difficulty."

"I did this because if we can agree together on the most prudent revenues we're likely to get, if the recovery stays and we do right things economically, then it will turn out better for the American people, let me say."

"In the last twelve years, because there were differences over the revenue estimates, you and I know that both parties were given greater elbow room for irresponsibility. This is tightening the rein on the Democrats as well as the Republicans. Let's at least argue about the same set of numbers so the American people will think that we're shooting straight with them."

(Applause.)

Senator Mack. It's difficult to argue with the President's logic in those statements.

What is confusing and perhaps somewhat disturbing is why the President chose to abandon his own pledge. Why did he change philosophies halfway into his Administration?

What is contained in this recent budget that can not stand up to CBO scrutiny? There must be something because, in fact, the CBO said last Friday that the President's new 10-year budget would produce cumulative deficits over 10 years exceeding $2 trillion dollars.

These figures are much different than the President's analysis.

The first difference is in the economic assumptions which cause the President's estimate of future deficits to be much lower than CBO's.

But it's not just a problem of GDP growth rates. The President's budget also relies on a fiscal bonus calculated by the CBO that forecasts lower interest rates. However, the CBO says that you're not entitled to the fiscal bonus until you've balanced the budget.

With the Administration's plan, you can't balance the budget unless you use the bonus. That's clever, but it's wrong.

The Republicans in Congress don't rely on the bonus to get to balance. We do it by cutting spending and making tough choices.

As I look over at Alice Rivlin, who is held in such high esteem for her long-standing commitment to deficit reduction, I have to wonder -- how do you really regard the latest effort by the President?

It seems that you, as the very first director of the Congressional Budget Office, would want the Administration's numbers to line up with CBO. You certainly must have advised the President to honor his commitment to use CBO numbers.

Robert Reischauer, another former head of the CBO and well respected by the Administration, has submitted a statement to the Committee this morning in which he writes, and I quote: "Prudence suggests that the Congress should stick with the CBO estimates of the size of the problem if it believes that it's important that the budget plan it adopts be viewed as one with a reasonable, but by no means certain, chance of eliminating the deficit by the target year."

Some in the Administration have argued that the difference between CBO estimates and OMB estimates are minimal, that two-tenths of a percentage point in economic growth doesn't amount to much over 10 years.

Well, what that amounts to is $1 trillion in higher deficits. There's no taxpayer in America who thinks that $1 trillion is minimal.

This isn't just a question of rosy scenarios and technical estimates. It's a question of being too clever and simply looking for shortcuts to avoid the real decisions and tough choices.

Sure, it's tempting to define away the problem with optimistic growth numbers and clever use of the bonus. But the President was right in 1993 when he said we should shoot straight with the American people.

I wish he would now.

I want to just use a couple of charts before I turn to you for your statement. And if you would, why don't you bring those over here a little bit further.

It's very popular these days to use charts in Congress.

Dr. Rivlin. Right. I'm going to use some, too.

Senator Mack. All right. Good. Dueling charts.

The three lines that are here represent three different budget resolutions, if you will. The top line was the first Clinton proposal. The second line is the second Clinton plan, re-estimated by CBO as far as deficits are concerned. And the third line, the bottom line, represents the budget resolution passed by the Senate.

I think there's a remarkable difference, or a marked difference, between these three lines. And the point here is that, again, while we embrace the President's statements that he wants to pursue a balanced budget, CBO's re-estimate of that budget proposal by the President runs deficits out over the 10-year period of $200 billion-plus.

I'm going to show these next two charts, this one representing again the decisions made in the Senate budget resolution. And I would refer to this in a sense as the size of the hole that has to be filled as far as deficits are concerned.

And we have chosen in the Senate budget resolution to do this through spending reductions, reducing the rate of growth in Federal spending.

This next chart, again, shows the same hole, but it is my estimate, the JEC's estimate, of what the Administration has filled the deficit hole with.

The first area is based on the rosier economic assumptions. And again, people say, well, it's only two-tenths of a percent. It doesn't really amount to much. Well, as the Director knows, two-tenths of a percentage compounded out over a 10-year period is a significant amount of money. And I would say that the combination of the economic assumptions and the use of the bonus amount to filling the hole, or halfway filling the hole with these changes in economic assumptions.

The balance of what you've done is spending reductions plus the interest savings that you get as a result of that lower spending.

You have actually made an assumption here that you're going to take care of half the deficit reduction over a 10-year period by a combination of changes in the economic assumptions and in using the bonus basically indicated by CBO because you balance the budget.

And the point that I made in my opening statement is that you can't balance the budget under your plan without using the bonus. And the point that I would make is you can't use the bonus until you've balanced the budget.

And so this combination of both economic assumptions and using the bonus just terribly and totally distorts the President's proposal that indicates that he gets to zero because I don't believe that he comes anywhere near that.

And with that, I will ask you to go ahead and make your opening statement.

[The prepared statement of Senator Mack appears in the Submissions for the Record.]

STATEMENT OF ALICE M. RIVLIN, DIRECTOR, OFFICE OF MANAGEMENT AND BUDGET

Dr. Rivlin. Thank you very much, Mr. Chairman.

I'll come back to your charts in a minute and show some charts of my own, but I'd like to get into the meat of the subject first.

The President's new 10-year budget is directed at the same goal that has been the single-minded objective of the Clinton Administration's economic policy from the beginning: Raising the standard of living of average Americans.

This budget reflects the same three principles that have dominated the Clinton Administration budget policy every year.

The first principle is that reducing the deficit is essential to raising future living standards. Reducing government borrowing will lower interest rates. It will increase private investment. It will reduce the debt service burden on taxpayers. It will make us less dependent on the rest of the world to finance our investments.

It is basically a good thing to eliminate the deficit if we are focused on raising future living standards for average Americans.

The second principle is that wise government spending can increase future living standards.

It sometimes sounds as though there are two schools of thought -- those who think that all government spending is bad, and those who think that all government spending is good.

The Clinton Administration believes that some kinds of government spending, especially spending for education and training, can increase the skills of the workforce. We also believe that investments in science and technology will increase future productivity.

We believe that reducing these kinds of public investments in order to balance the budget is self-defeating. The purpose of reducing the deficit is to raise future living standards. Reducing the deficit by making cuts in those programs is the wrong way to do it.

The third principle is that affordable health care for all Americans is vital to our future standard of living.

At the very least, we must avoid making health care less available and more expensive to people, especially seniors and low-income families.

We must take steps toward making health care more efficient, more affordable, and more available.

In the first two years of the Clinton Administration, the President's economic plan brought the deficit down dramatically. The President took risks in espousing that plan in early 1993.

At the time, the economy was growing sluggishly and the deficit was spiraling out of control. Many warned that aggressive deficit reduction would cause a recession. The Administration gambled that interest rate reductions would jump-start the economy and overcome the fiscal drag of reducing the deficit. We were right. The gamble paid off.

As it turned out, the Administration's economic projections weren't rosy enough. The economy did better and the deficit came down more than had we predicted in early 1993.

The President took political risks as well. Not a single Republican had the courage to vote for that deficit reduction plan. Many campaigned against it, some successfully, in November 1994.

None, so far as I know, want to repeal it now.

If the President hadn't made that degree of progress on the deficit, we would be in much more trouble than we are now.

The budget we have just released brings the deficit down to zero over 10 years. It is not really a new budget. It builds on the budget that we put out in February.

In that budget, we cut discretionary spending by about $200 billion over seven years. We weren't using 10-year numbers then, but that's the equivalent.

We focused on discretionary spending. We examined the major departments of government, asked questions about which programs were necessary, which could be privatized, which might be done better by state and local government. We also restructured major departments -- Transportation, HUD, Energy, and others -- to achieve major savings.

We also continued to shift resources from wasteful and low-priority activities into investments in the future, especially in education and training, and science and technology.

In the February budget, we did not propose a new effort at health reform. We said we would come back to that subject and expressed a desire to work with Congress. In both the budget and the President's

State of the Union, we emphasized that slowing the rate of growth of health care spending was essential to deficit reduction, but that it had to be done in conjunction with steps towards broader health care reform.

We also said that we would come back to the subject of welfare reform.

The President has now come back to those subjects. We have issued a new budget which not only fulfills the promises of the February budget but builds upon it as well.

This budget eliminates the deficit over a 10-year period.

We didn't choose that date at random. We chose policies we believe are the right ones for achieving a higher standard of living in the future and reducing the deficit. We put those policies together and they led us to balance over a longer period -- 10 years, not seven -- and in a very different way from the Republican budget.

Our spending cuts are in four areas.

In discretionary spending, we continue the cuts outlined in the February budget but increase investments in education and training. This is a defining priority for the President. Our budget increases education spending by about $40 billion over the seven-year period. The House and Senate budget resolutions decrease education spending by the same amount from current spending levels.

The second area of cuts is health spending, Medicare and Medicaid.

Our cuts in Medicare are much less deep -- about half the size of the cuts provided for in the Republican resolutions -- and they fall on providers, not on beneficiaries.

With Medicaid, we have cut much less deeply from the Republican resolutions. We believe that cutting deeply into Medicaid will cut coverage for our most vulnerable citizens.

We also propose a series of reforms in the health care system and modest expansions in coverage, especially for the temporarily unemployed.

We have savings in welfare reform. We have savings in other entitlements, such as agriculture programs, although our cuts are much less deep than those in the House and Senate resolutions.

In student loans, we continue to get savings by accelerating the movement toward direct loans. But we do not load additional interest charges on student borrowers.

So this is a budget that gets to balance more slowly than the Republican versions. It has a different set of priorities -- less drastic cuts in Medicare and Medicaid and increases for education and training. We believe these increases are essential to high wages in the future.

Now a word about the assumptions.

Every budget has to start from a baseline. The baseline has to answer the question -- what do you think the budget would look like if we didn't make changes?

To get our baseline, we used the same economic assumptions that we used in February. This is not a new set of assumptions.

We have relied on OMB's economic assumptions in every year of this Administration, except for the first year when, as you know, we used CBO assumptions for our first budget. At that time, we were coming into a situation where the outgoing administration had a very poor record of credibility on forecasts and estimates.

We believe we have now corrected that record.

The differences between our current economic assumptions and those of the Congressional Budget Office are small and technical sounding.

There are two kinds of differences. One is a very small difference in the assumed growth rate in the economy. We are assuming 2.5 percent growth for a few years and then 2.4 percent growth. That is a conservative growth rate compared to private forecasts. The so-called blue chip forecast, an average of private forecasting services, chooses 2.6 as their long-run estimate of the gross domestic product growth rate.

The Philadelphia Federal Reserve, in conducting a survey of forecasters, has also endorsed 2.6 percent growth.

So 2.5 or 2.4 percent growth is certainly not a rosy scenario and the CBO, in choosing 2.3, is slightly less optimistic than we are.

The other big difference is in medical care inflation assumptions. Again, these are small differences in rates of growth.

Fortunately, medical care inflation has been coming down. A couple of years ago, we were all forecasting Medicare and Medicaid growth rates that were in the double digits -- 10, 11, 12 percent growth -- which was scary, indeed.

Those growth rates have come down, and we hope they will continue to come down.

For Medicare, we are now forecasting a growth rate of 9.1 percent. CBO, which has also lowered its growth rate forecasts as inflation has come down, is at 9.7 percent.

Everybody is somewhere in the nine point something.

We don't make up these numbers. We don't have health care forecasters at the Office of Management and Budget. We rely on the actuaries at the Department of Health and Human Services. These actuaries are professionals who have been doing this sort of thing for many years. They are the same actuaries that the Republicans have been relying on for estimates on when the Medicare trust fund will run out of money.

The actuaries are the respected long-term professionals and we rely on them for our estimates. They believe that medical care inflation is moderating somewhat.

Over the last several forecasts, the CBO has lowered its estimates. They have followed us down progressively, but they still see a slightly higher rate of medical care inflation than we do.

These are not rosy scenarios. If I may show a chart or two myself.

(Pause.)

There has been reference to the differences in 1991 between the Administration and the Congressional Budget Office, a period I remember extremely well because I was heading the Congressional Budget Office at the time.

The left side of the chart shows the 1981 OMB and CBO forecasts for growth rates and unemployment. You can see that there are large differences between the projections.

If you look at the right-hand side of the chart, which shows the growth rate differences in the bottom and the unemployment differences at the top, between CBO and OMB now, you will see that they are very small differences, indeed.

Similarly, with interest rates and the consumer price index, if you look at the difference between the 1981 forecasts shown on the left, you will see that they are large, indeed. But if you look at the right-hand side, you will see that the differences now are extremely small.

We are very close.

Nobody knows what's going to happen 10 years out on growth rates on inflation or any of these numbers. Professionals do the best they can to make accurate forecasts. At the moment, the professionals are quite close.

Now if you run the numbers out for 10 years, the differences accumulate.

But let me point out one thing which was true on the House side that's not true in the Senate. In order to get the budget resolution to balance on the House side, they awarded themselves a growth bonus as well as an interest rate bonus. It's not in the baseline, but it contributes to achieving balance.

Now we believe that interest rates will come down as we reduce the deficit. So we have accepted the notion that is inherent in both budget resolutions: interest rates will come down as the budget moves toward balance.

CBO, as you pointed out, did not accept that interest rate bonus when it did its estimate of our budget. If CBO applied the same standard to the House budget resolution, it wouldn't balance, either.

Thank you, Mr. Chairman. Let me just add one more thought.

It seems to me that we shouldn't spend a lot of time talking about differences in the estimates. What we need to focus on are the very real differences between the approaches of the Administration and the Congressional majority about how you get to balance, what the priorities should be, and how quickly you move there.

That's what it's really about. When we come to a negotiation between the Administration and the Congress to make a final budget, and we will get there, we will have to agree on a common baseline. That always happens and it won't be very difficult. The differences, as I pointed out, are small and we can surely agree on a common set of numbers.

The priorities and the rapidity of getting to balance are really at issue.

Thank you, Mr. Chairman.

[The prepared statement of Ms. Rivlin appears in the Submissions for the Record.]

Senator Mack. Director Rivlin, thank you very much for your testimony and thank you for being here this morning.

I understand your desire to move away from the discussion about baselines. But at this stage of the game, frankly, I think that there is the issue here about the credibility of the proposal that the Administration has put forward.

As I said earlier, I welcome the President's commitment now to a balanced budget. That's something that we've been talking about for a long time. And when I say we, frankly, I include you in that. As long as I've been here in this budget discussion, you've been here and been here much longer than I.

But the reason that we are focused on the issue of baselines and different assumptions is because the President, made such a point of it a few years ago, in essence, saying that he didn't want the debate in the Congress to get off on these issues, that he wanted to really get the debate focused in on priorities.

And as was pointed out in the tape of the President's speech before the Joint Session of the Congress, and I will read it again, he says, referring to using CBO numbers, "I did this so that we could argue about priorities with the same set of numbers. I did this so that no one could say that I was estimating my way out of this difficulty."

And he went on to point out that, "In the last 12 years, because there were differences over the revenue estimates, you and I know that both parties were given greater elbow room for irresponsibility."

And the point is, and we have all seen many deficit reduction plans over the years that we've been around here. And isn't it interesting that no matter how many of these plans we passed -- and I can remember everyone talking about this mammoth reduction of $500 billion -- the deficit still remains at, according to CBO, much higher --

Dr. Rivlin. Well --

Senator Mack. Let me finish my point. The President made the point that we need to use CBO so that we work off the same set of numbers.

I'm at a loss to understand why now he has shifted because this puts us back into a situation where we're going to debate baselines.

The second point that I want to make is this issue of two-tenths of a percentage growth.

Over 10 years, that amounts to a tremendous amount of money. And the reason I think the CBO is not giving you credit for a bonus, in their estimate of the President's proposal, is because of the tremendous amount of so-called deficit reduction that comes because of the change in the baseline due to economic growth.

Nobody believes that, number one. And the second point that they don't believe is that you can balance the budget by using the bonus that can only come to you as a result of balancing the budget.

So I'm afraid that we're going to have to debate this issue about baselines and economic assumptions for a while.

I'm curious though. Why didn't the President give us a 10-year budget back in February, as opposed to what he did propose?

What happened to change the situation that the President wanted to come forward now with a balanced budget proposal?

Dr. Rivlin. The President made very clear in February that he was for further deficit reduction. He said very clearly at that time, and in the State of the Union Address that we would come back with a health care proposal and that we wanted to work with Congress on that.

He said clearly what is obvious to everyone that looks at the budget: Unless you slow the rate of growth of Medicare and Medicaid, we will have rising deficits.

The growth rates for those programs have been rising faster than the revenue growth rates.

So we have a built-in problem here. Medicare and Medicaid spending has been rising faster than anything else and will, if not slowed, be the source of future deficits.

We made that point very clearly. We did not put a health care reform proposal on the table in February because we weren't ready to and we wanted to work with the Congress on formulating one.

Later, it seemed appropriate to revisit health care and welfare reform, which were not in our February budget, along with other entitlements and together a budget that would get to balance.

I think we were impressed with the need for a budget that would get to balance. Clearly, the February budget didn't achieve balance. But in February we said clearly that further efforts would be necessary, especially in the area of health care reform, if we were going to achieve additional deficit reduction.

Senator Mack. Again, a personal comment.

It just seems to me that what happened is that the President was on one of the talk shows that he likes to do and was asked a question and he made a kind of off-the-cuff remark that we're going to put together a plan that's going to balance the budget in 10 years and then people had to scramble around to put together a plan and that's how we ended up with it.

Dr. Rivlin. Not so, Mr. Chairman. The President may have referred to it in an off-hand way, but this was not an off-hand budget. This was a very serious effort.

We did not start with the target date of 10 years. We started with the policies first and thought it might come together in nine years, then we extended it to 10 years.

Senator Mack. Are you of the opinion that cutting spending over seven years, as Laura D'Andrea Tyson has indicated, would be bad for the economy?

Dr. Rivlin. I don't think we can tell for sure. It is safe to say that when you reduce the deficit, it has some restraining effect on the economy. If you slow down the economy too much, you'll run the risk of a recession.

The faster you reduce the deficit, the more risk you take. Nobody can tell you exactly how large that risk is.

But the risk factor was only part of the reason for why we chose the slower path toward balance. More importantly, we chose the slower path because we believe that the kind of draconian cuts, especially in Medicare and Medicaid and education, that are necessary to get to balance quickly while financing a large tax cut, are undesirable for the American people and for the standard of living in the future.

Senator Mack. So you recognize that there is a risk, but you're not willing to go so far as to say that doing it in seven years as opposed to 10 is an extreme difference in the two approaches.

Dr. Rivlin. From a fiscal policy point of view, no. But it does certainly raise the risk of restraining the economy.

Senator Mack. I had a kind of remarkable experience, I think it was yesterday, with Chairman Greenspan.

As you know, when you ask Chairman Greenspan a question, the answer that you get is usually quite lengthy and you have to kind of work through the answer several times to kind of figure out exactly what he's telling you.

Yesterday, I asked him the question. I said, "You know, over the years, I've heard you say, Mr. Chairman, that you have never worried about the Congress cutting spending too deep or too fast."

And I said to him, "are you still in that mode today?"

And his response to me was one word -- "yes."

And what he is saying and I think, frankly, what you're saying, and we have a statement from Robert Reischauer as well indicating that they are not overly concerned that the rate of reduction in Federal spending is going to be a major factor on the economy.

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Dr. Rivlin. No, I think that's right. I think we all are agreed that bringing the deficit down is good for the long-run health of the economy. There is some short-run risk, but not a great deal.

Senator Mack. I'm going to now turn to my colleagues. Representative Ewing?

OPENING STATEMENT OF REPRESENTATIVE THOMAS W. EWING

Representative Ewing. Thank you, Mr. Chairman, and Director, thank you for being here.

I had the very same first question that our Chairman had as to why the President waited to come out with his budget.

I still have that question. I'm not sure that your answer gave me any insight into why we didn't get a 10-year budget the first time that takes us to a balance.

Would you want to try again?

Dr. Rivlin. I can rephrase the original answer. I think that in February we were not ready to put a health care plan or a welfare reform plan on the table. We needed more time to work on it. We wanted to sound out where Congress was.

So we said very explicitly that our budget did not include health care reform, that it was important to do that and that we really realized we could not get further deficit reduction without slowing the rate of growth of Medicare and Medicaid. But we wanted to do that in the context of the first steps toward health care reform.

We said that and now we've done it. It shouldn't have been a surprise to anyone who was listening in February that there would be a new part to the budget, even if we didn't telegraph that we would do a 10-year plan. At the time, we weren't sure if we were going to do a 10-year plan.

Representative Ewing. Well, I think there was a surprise. I would have to disagree with you. And I was listening to the President on that issue because I think it's very important.

I think the American people were listening also.

Question -- under the President's plan in the first year, does the deficit go down or up?

Dr. Rivlin. Well, a lot depends on what happens to the rescission bill.

Representative Ewing. But in the President's plan --

Dr. Rivlin. It went up slightly.

Representative Ewing. Yes. When does the deficit start down? In the second? Third?

What year?

Dr. Rivlin. In our original plan --

Representative Ewing. In the 10-year plan.

Dr. Rivlin. In the 10-year plan, the deficit goes down in '96. There is a blip up in '97, which is in all the plans. The deficit then comes down steadily from '97 on.

Representative Ewing. Well, my charts, Director, show somewhat different, somewhat of a steady line up through '97, and then starting down with the deficit.

Dr. Rivlin. Well, what we have is a very slight decrease of $8 billion in '96. The deficit then goes up again in '97 and then goes down steadily beginning in '98.

Those are our official numbers.

Representative Ewing. I think that, again, my judgment of the tenor in the country is that they find very little enthusiasm in a budget that continues to show deficit up, with promises of down, because under administrations of both parties, and certainly under the old Congress, that was the promise we always got -- deficit reduction in the out-years. We got new spending in the short-term and deficit reduction in the out-years.

And the out-years never got here.

Dr. Rivlin. Well, let me remind you of what has happened in the last two years.

When the Clinton Administration began in early 1993, the deficit was headed up. In fiscal year 1992, it was $290 billion.

We have gotten it down to under $200 billion. For this year, we are estimating the deficit will be around $190 billion. It will probably be lower than that.

That is a very good record of deficit reduction, a better record than even we projected. There has been a lot of talk about how people always project the deficit coming down and it never happens. But in the last two years we have brought the deficit down and it has happened more rapidly than even we projected.

Representative Ewing. Mr. Chairman, are we going to have a second opportunity? My time is up.

Senator Mack. We'll see.

Representative Ewing. Thank you.

Senator Mack. Senator Santorum?

OPENING STATEMENT OF SENATOR RICK SANTORUM

Senator Santorum. Thank you.

Thank you, Dr. Rivlin, for coming and testifying. We appreciate it.

I'm also wondering what the real effects are of these changes in assumptions. One of the big areas of concern has been the area of Medicare and the President coming in with what he announced as half the reductions in the Medicare budget than what the Republicans have suggested in the House and Senate.

But when I look at the numbers there's the rub.

The rub here is that if you look at what is actually spent on Medicare, under the budget that the President puts forward and what we spend on Medicare in the budget that the Senate Republicans have put forward, in the first few years, we spend more money on Medicare than you do.

Now, the Administration suggests that, and I'll give you the numbers. This is the numbers I have -- it's faxed from the Office of Management and Budget here. It shows your numbers for Medicare, mandatory spending, and you compare them with the numbers that we have in the Senate budget.

In '95, you have $154 billion for Medicare. In the Senate budget, $178. In '96, you have $172 billion for Medicare. We have $187. In '97, you have $186. We have $198. In '98, you have $199. We have $213. In '99, you have $213. We have $228.

You talk about the draconian cuts in the Republican budget for Medicare, but we're spending more dollars under our projections for Medicare than you are.

So that's why I sort of scratch my head and say, how can you say we're hurting the Medicaid program more if we're spending more money on it?

So, obviously, these assumptions do matter. And what you're suggesting as far as the growth rate, you say, well, it's just a minor difference in growth rate. You're projecting 9.7. We're projecting 9.1. But at the same time, we're spending more money on the program.

So how can you say ours is mean if we're spending more money?

Dr. Rivlin. In order to get your spending level from your assumed baseline, you would have to cut specific services and provider payments much more drastically than we would.

If we look at the specific set of cuts that we think are behind the Senate plan, and compare them to the ones that we know are behind ours, we find that the Senate plan's cut would be about twice as much as the cut we are proposing.

Now, it's true that the projections you're starting from assume higher rates of inflation in Medicare. But we think that's unlikely. We think our inflation rates are more plausible. That's the difference.

Senator Santorum. So what could actually occur is that if we follow through and we follow the Republican course here in the Congress, and assume that's accepted, just for purposes of this hypothetical, we could actually cut Medicare more than we need to and end up with large surpluses in Medicare in the future, if what happens, your economic assumptions are correct. Which means that we could actually then go back and do some things to actually extend benefits or do something different.

If we find that in fact we're getting surpluses because we're saving much more money than we needed to that we actually could go back and look at the program and see what we could do to redesign the program to better reflect a sounder path.

I guess, isn't that the more prudent way to go about it?

Dr. Rivlin. Well, that depends on whether you're a Medicare beneficiary. If I were a Medicare beneficiary and a Republican Senator were saying to me, to be prudent, I'm going to cut your benefits more than I need to, and I'm sorry about that --

Senator Santorum. I think there's an argument there as to whether we need to or not.

Dr. Rivlin. It may be prudent from some points of view, but we do not believe that cutting into Medicare more deeply than is necessary is the right thing to do.

Senator Santorum. I guess, again, I want to come back to the fact that we still are spending more money. So, I think that's not a point that I want to gloss over here.

You say, well, you're going to have to reduce spending and you're going to have to put programs together and reduce spending.

But to suggest in the Republican budget that we, somehow or another, aren't willing to spend more money on the program, we are. Just basically assume away a bunch of money that we feel we have to cut.

Dr. Rivlin. No, I don't think so, and let me rephrase what you said.

If your assumptions about the rate of medical care inflation are correct, then Medicare spending would remain as high as you say. But the services to the individuals, because each individual service is more expensive, would have been cut.

Senator Santorum. Again, this comes in and goes back to what Senator Mack was saying. This comes to the real problem here with not using the same set of numbers.

You get off the track here on arguing whether your assumptions are right or our assumptions are right and maybe we can -- and this may be a way to begin to facilitate it -- agree on a certain set of numbers.

I thought we had because the President, as you showed, I thought we had agreed on a certain set of numbers we were going to use. But maybe we need to go back and figure out how we can agree on numbers again because I think it's not beneficial to the country if we're all out here arguing apples and oranges. And we are arguing apples and oranges right.

Dr. Rivlin. Yes. But --

Senator Santorum. And that was not to be the case.

Dr. Rivlin. Well, I would agree. And, as I said earlier, when we get to the negotiating stage there will have to be a negotiation between Congress and the Administration over a final budget. At that point, we will have to agree on a common baseline.

But let me correct the false impression that we suddenly have a new set of numbers.

The clip of the President from February 1993 reflected our very first budget. After that, we re-established the credibility of OMB numbers. We used them for the '93 mid-session review and have been using them since that time. We didn't suddenly switch. We have been using OMB numbers since the summer of '93. It's now the summer of '95.

Senator Santorum. I would suggest that the previous occupant of your position under a Republican Administration felt that their numbers were better than CBO numbers and that they had corrected the problems in the past, too.

But you are consistent in the sense that the OMB numbers are as they have been in past administrations, more optimistic than the Congressional Budget Office.

Dr. Rivlin. They're very slightly more optimistic.

Senator Santorum. Well, but over a period of 10 years, that slight difference means a big number.

You said you're using the same numbers. The President's first budget that he put forward was a five-year budget. So you used five-year estimates.

Am I correct?

Dr. Rivlin. Yes.

Senator Santorum. But now you're using 10-year estimates. So you may have used the same numbers, but --

Dr. Rivlin. They're the same assumptions, yes.

Senator Santorum. You're projecting them out five more years.

Dr. Rivlin. That's right, and so is CBO.

Senator Santorum. That's the difference.

Thank you, Mr. Chairman.

Senator Mack. Before I turn to Senator Grams, I can't help but make a point because you've referred several times to the credibility of OMB.

If there is an increase in credibility as a result of what you've done in the past, it's because you used CBO as the basis back in 1993. And now you have switched.

That's point one.

Point two is frankly, nobody paid any attention to the President's budget when he sent it up here in February because it didn't do anything to the deficit. Why worry about what the assumptions were?

Now the President has signaled that he's interested in getting involved in this debate. Now that we've heard him say that he wants to get into the debate, we're going to look pretty closely at his numbers. And when we look closely at his numbers, we are deeply concerned that half the deficit reduction that takes place under the 10-year proposal comes because of, in our opinion, rosy scenario numbers.

Senator Grams?

OPENING STATEMENT OF SENATOR ROD GRAMS

Senator Grams. Thank you very much, Mr. Chairman.

My first question was the same as the Chairman's. My last one was the same as Senator Santorum's. So I think we all have a lot of the same concerns that we're comparing apples and oranges.

Did your office, Dr. Rivlin, ever use CBO scoring in this budget and then took the best of the two?

Dr. Rivlin. No.

Senator Grams. You've never done that? You didn't compare the two numbers or the scenarios at all?

Dr. Rivlin. Since the summer of '93, when we did our mid-session review, we have consistently used our own scoring and our own economic assumptions.

We used CBO numbers in February 1993, in part, because we had just taken office and didn't feel very confident about our own set of forecasts.

So we decided, for the reasons the President enumerated on that evening, to use CBO for our first budget. We have not used them since. It's not that we don't know what CBO does or communicate with them occasionally on how they view the budget or how we view the budget. But we have not used CBO assumptions since our first budget.

Senator Grams. Just for your own information or curiosity, you never cross-checked the numbers to see?

Dr. Rivlin. Oh, sure. We look at what they do. We're avid customers of their reports, just as they are avid customers of ours. But we make our own estimates.

Senator Grams. What would our Republican budget look like if we used OMB numbers? I think we'd end up with a huge surplus of $200-plus billion dollars in the year 2002.

Dr. Rivlin. Yes, you would.

Senator Grams. If we compared those same numbers.

Senator Mack. Is that correct?

Dr. Rivlin. That's correct.

Senator Grams. So if we compared them -- the congressional budget as scored by CBO, and the President's budget, scored by CBO -- we'd see stark differences.

Currently, we've got the Administration running on the CBO. We've got Congress on the CBO track. And it's the taxpayers who are the losers in this whole event.

Dr. Rivlin. Well, the program beneficiaries themselves -- Medicare and Medicaid beneficiaries -- may also be losers in this whole event.

If we do what you want, they will be the losers, and so will people who won't earn higher incomes in the future because they couldn't get training, and kids who won't get to college because they couldn't afford student loans.

Those people will be losers as well, and we think that's bad for the economy.

Senator Grams. Dr. Rivlin, you like to put faces on the recipients. But what about the faces on the families that pay these taxes, the family that makes $35,000 a year and continually foots more of that to the Federal Government to pay for the wanton spending of Congress?

There are faces behind those people who have to give up those dollars and their children do not get the college education because they have no savings to do that.

But let me go on.

Dr. Rivlin. None of us are proposing a tax increase. That's one thing we agree on.

Senator Grams. Not this year with a Republican Congress, thank goodness.

The President -- or should I say, Secretary Treasury Rubin said on Sunday that the Administration budget proposal was a very serious effort by the President. He said the President has worked on this for at least six weeks.

Is that a serious effort, in your estimation, of putting together a budget in six weeks?

Dr. Rivlin. The President has worked on it for six weeks. Some of us have worked on it longer.

Senator Grams. Okay. If this is an honest budget proposal, why weren't the leaders of Congress, the Democratic leadership, brought in on this as well and allowed to have their input included?

It appears to me that this budget was as much a surprise to the Democratic leadership as it was to the Republicans.

Dr. Rivlin. Well, I guess I'm a little mystified as to why everybody was surprised that we did it.

Senator Grams. They weren't included in any discussions?

Dr. Rivlin. I thought we had telegraphed very clearly that we would return to health care reform and welfare reform.

What was a surprise, I think, was the timing. We talked a lot about the timing. The President felt very strongly that it was important to get it out to make a speech about it and dramatize his commitment to a balanced budget and to health care reform. He felt June 13th was the moment to do it.

Senator Grams. Two other quick questions before I close here.

You mentioned concerns that if we reduced the deficit too quickly -- in seven years rather than 10 -- that it could have detrimental effects on the economy, and could put us into a possible recession.

Dr. Rivlin. I didn't say that. The Chairman asked me if I thought the possibility of a recession was a major reason for going to 10 years. I said it was not a major reason.

You do take slightly more risk with the economy if you reduce the deficit quickly. But our major reason for taking longer to achieve balance was that we do not think that the draconian cuts are good for the country.

Senator Grams. Well, again, if we have smaller deficits, that means less borrowing and I think everybody agrees that less bor-rowing is better for the country.

But as Senator Santorum mentioned, when you talk about the "draconian cuts", the bottomline is we are spending more money.

So do you still believe there are draconian cuts in these programs?

Dr. Rivlin. Yes, there really are.

Senator Grams. Compared to your budget?

Dr. Rivlin. There really are and I think the big differences are in priorities.

The one I mentioned earlier is perhaps the clearest -- education and training. Our budget increases spending, and we make no bones about this, for education and training, because we think that good education and training are the keys to securing higher incomes and higher wages in the future.

That's what this is about. It isn't about balancing the budget for bal-ancing's sake. The reason we're all for getting the deficit down is to increase the future standard of living. But we can't do it at the expense of programs that contribute to the future standard of living.

Senator Grams. You talked about how you've reduced the budget under the '93 Clinton proposal from $290 to $190 billion in deficit.

Dr. Rivlin. Right.

Senator Grams. How did you do that? There is no reduction in spending. Costs have gone up.

Has it been done more through short-term borrowing, lower interest rates, that has been beneficial to the programs?

Or are you saying that you're actually spending $100 billion less?

Dr. Rivlin. I'm saying that the difference between spending and revenue has narrowed by $100 billion. The reason that happened was about half due to changes on the spending side, and about half due to changes on the revenue side.

The improving economy certainly increased the revenues, as did changes in interest rates.

But in the original plan, the spending cuts and the revenue changes were divided roughly half and half.

Senator Grams. Dr. Rivlin, you said sometime down the road in the negotiations, we would have to come together on some common set of numbers.

Dr. Rivlin. Right.

Senator Grams. Are you eager to compromise these numbers, OMB to CBO, and at least have a common ground so that we can compare apples to apples and not apples to oranges?

We're coming out with a budget at the end of this week to the floor before the 4th of July. Do we have a lot of time left for such negotiations?

Dr. Rivlin. Well, negotiations have not started. The President has put a budget on the table and the two budget committees are moving ahead with their conference.

As you know, that's only the first step. We will then move into the appropriations phase and the reconciliation phase.

I am saying that, at some point, we will want to have a negotiation over the final product. It may not come until September. It may not come until later than that. But at the point of negotiation, we will need to have an agreement on the baseline as a first and, I think, fairly quick step.

Senator Grams. Thank you very much, Doctor.

Senator Mack. I only have a couple more comments to make and then I think we'll have June O'Neill come forward with her testimony.

I'm going to go back again to some of the comments I made earlier. I think it is an important issue as to the numbers that you all chose to use. I recognize that you say this is not some dramatic change, and that you used them in February.

I guess why I'm a little bit concerned about all of this is you have been on the forefront of this battle to reduce the deficit. And back in 1982, you said administrations always take the optimistic end of the range of uncertainty. Frankly, this Administration is doing exactly the same thing.

I think what you're saying in essence is that this kind of thing that leads us into not really solving the problem.

And the second thing that happened as a result of the decision to use OMB's economic assumptions is that when the proposal was finally made by the President, and the reason that really no negotiations have taken place, at least from my perspective, is that the budget leaders in both the House and the Senate looked at this proposal and in essence came to the same conclusion that I did, which is in the chart that I used a little bit earlier.

You have dealt with this $3-plus trillion dollar hole by assuming that you've filled it, half of it, with the changes in the economic assumptions, or economic assumptions different from what CBO has put forward.

And I think that when June O'Neill gets here a little bit later, she is going to lay out exactly those reasons as to why there is this big difference.

The second point is that you're using a bonus which I would say you're not entitled to. You only get a bonus, if in fact, you balance the budget. Your plan does not balance the budget without using the bonus, and I think that's a significant point.

And the third point -- and I know you're anxious to respond -- is that in the first five years of your proposal, only 21 or 22 percent of the spending reductions take place. Seventy-eight percent of the spending reductions take place in the five years at the end of this effort.

I don't think, frankly, at this point, that this plan has credibility.

I will again close with what I started out with and you have re-emphasized here: that at least the President says he wants a balanced budget. At least the President has said that he doesn't want to do it by raising taxes. And at least the President said he wants to reduce spending further.

But I think that there is a tremendous lack of credibility with respect to the plan.

Dr. Rivlin. Well, let me respond briefly.

On the interest rate bonus, I don't know of any rule that says that financial markets need to see a deficit reach absolute zero before they recognize that a deficit is coming down.

We believe, as does CBO, that if we're on a solid path to deficit reduction, markets will recognize that and interest rates will also come down.

That's the bonus. There isn't some guy out there awarding a bonus.

Senator Mack. And you do get credit for that. There is real interest rate savings as a result of bringing the deficit numbers down, and I think most people reflect that, that in fact will take place.

Dr. Rivlin. No, I'm saying something different, Mr. Chairman.

Everybody agrees that if the deficit comes down, we'll spend less for debt service at the same interest rates. We all agree on that. The question is: Will we have an additional reduction in debt service from the fact that interest rates will come down?

I'm saying that when the financial markets recognize that the deficit is coming down, interest rates will come down as well.

You're quite right in saying that I believe deficit reduction and getting to balance is a very important thing for our future standard of living. But I also believe, and have always believed, that it's not the only thing. How we get there matters a great deal.

If we cut deeply into programs that are crucial to raising the standard of living, we're not doing the right thing for the American people.

Senator Mack. Again, I thank you for your testimony this morning and appreciate your being here.

Dr. Rivlin. Thank you, Mr. Chairman.

Senator Mack. Thank you very much.

Our next witness is Dr. June O'Neill. She is the director of the Congressional Budget Office.

I might say, prior to assuming her post at the CBO, Dr. O'Neill was the director of the Center for the Study of Business and Government and a professor of economics and finance at Baruch College and Graduate Center of the City University of New York.

We're delighted to have you with us this morning. Please proceed with your opening statement.

STATEMENT OF JUNE E. O'NEILL, DIRECTOR, CONGRESSIONAL BUDGET OFFICE

Dr. O'Neill. Chairman Mack and members of the Committee, I am certainly pleased to be here with you this morning to review the budgetary plan that the Clinton Administration released on June 13.

I will summarize my prepared statement, if that is all right, and submit the statement for the record.

Senator Mack. Fine.

Dr. O'Neill. The five-year budget that the Administration submitted in February would not have substantially changed the budget deficits projected under current policy. By contrast, the Administration's revised plan for the next 10 years includes additional reductions in spending and increases in taxes designed to make large reductions in the federal deficit.

My comments today will describe Congressional Budget Office's (CBO) preliminary assessment of the Administration's new plan and explain the differences between CBO's estimates and those of the Administration.

The Administration's February budget recommended changes in policy that would have reduced the cumulative deficit by only about $30 billion over the period between 1995 and 2000. The President's June budgetary plan retains most of the elements of the first budget, but it also extends the fiscal horizon through 2005 and assumes additional savings intended to achieve budget balance in 10 years.

Reductions in discretionary spending would account for close to half of the reductions. The other major areas in which spending reductions would occur are Medicare, Medicaid, welfare programs, and corporate subsidies.

The Administration's June package also contains several health initiatives. In addition to providing for spending reductions in Medicare and Medicaid, the Administration proposes a number of new benefits, including health insurance subsidies for the unemployed for up to six months, grants to states for home- and community-based long-term care, Alzheimer's respite care benefit within the Medicare program, and elimination of the co-payment for mammograms, also in the Medicare program.

As explained by the staff of the Office of Management and Budget (OMB), the additional budgetary savings included in the Administration's new plan are indicative proposals that as yet do not represent specific policies. Therefore, a detailed, program-by-program evaluation of the President's June budget is not possible at this time. For that reason, CBO has relied on the Administration's own estimates of the proposed savings in preparing our preliminary assessment of the budgetary effects of the President's new plan.

Because of the different budgetary rules governing discretionary and mandatory programs, CBO has used different methods for calculating savings in the two budgetary categories. Briefly, for defense and nondefense discretionary spending, CBO's estimates assume the level of outlays specified in the President's plan. However, for the mandatory spending programs -- that is, the entitlements -- and revenues, CBO simply uses the net savings or costs of the policy changes that are specified by the Administration and then applies them to the CBO baseline.

Our bottom line is that the President's June budget plan would hold the total deficit to about $200 billion a year if the plan is enacted and implemented as assumed. A budget deficit of $200 billion would represent about 2 percent of the (GDP) by the year 2005. But that would be a reduction from the deficit CBO is projecting under current policy. The CBO baseline deficit is about 3 percent of GDP averaged over the 1995 = 2005 period.

The reduction in the deficit under the President's policies would allow for a modest drop in interest rates compared with those in CBO's baseline. However, because of the uncertainty surrounding the President's plan and the estimates of its effects on the budget, CBO has not incorporated a drop in interest rates attributable to deficit reduction in its estimate of the Administration's plans. But even if an allowance was made for the effect of an interest rate drop, the deficits under the President's June budget would likely remain near $200 billion through 2005.

In contrast to the deficit of $209 billion in 2005 estimated by CBO, the Administration projects that its policies would produce a budget surplus of $18 billion in that year. What accounts for that difference of almost $230 billion between the two estimates?

The most important reason for the difference in estimates is that the deficit projected by CBO under current policy -- that is, the baseline deficit -- is much higher than that projected by the Administration. CBO projects that the baseline deficit will reach $454 billion in 2005. By contrast, the Administration's baseline shows a deficit of only $266 billion for 2005.

Excluding differences in discretionary spending, CBO's projected baseline deficit exceeds the Administration's by almost $170 billion. Because of the large differences in the deficit expected before any policy change is made, the same dollar reduction in spending will leave a larger remaining deficit when applied to CBO's higher baseline.

As Bob Reischauer puts it, the Administration has a lower bar to jump over than the Congress, which uses the CBO baseline.

The next question is why is the CBO baseline higher than the Administration's? A key factor here is the difference in economic assumptions. Although the economic assumptions of CBO and the Administration may appear to be quite similar, the differences in assumptions are, in fact, sufficient to produce marked differences in budget projections, differences that only grow over time.

On average, the Administration foresees slightly faster real economic growth than does CBO. For technical reasons, the difference in the growth rates of the consumer price index (CPI) and the GDP deflator is also an important factor. CBO assumes that the CPI will grow significantly faster than the deflator, whereas the Administration assumes only slightly faster growth in the CPI.

Largely as a result of differences in economic assumptions, CBO's projection of revenues in 2005 is $62 billion below the Administration's, and that revenue difference accounts for close to 30 percent of the overall difference in deficit estimates. Differences in modeling techniques and programmatic assumptions also contribute to the difference between CBO's baseline deficit and that estimated by the Administration.

In 2005, $52 billion of the difference in projected spending can be traced to differences in projected spending for the Medicare and Medicaid programs alone. Although CBO believes that the growth of those programs has slowed from the extremely high rates of recent years, it is not quite as optimistic as the Administration about the extent to which such a slowdown would occur without any change in policy.

Differences in estimates of other entitlement programs and net interest contribute \$53 billion to the difference between the baseline deficits of CBO and the Administration.

Baseline differences, however, do not account for all of the differences in the estimates between CBO and the Administration. The major remaining factor is that the Administration assumes large additional savings from lower interest rates.

For example, in 2005, the Administration claims a credit of more than \$60 billion for the fiscal dividend that would result from lower interest rates. However, CBO believes that the Administration's plan would produce a much smaller fiscal because, as I have indicated, we estimate that the amount of deficit reduction attained would not be sufficient to achieve a fiscal bonus of that size.

In conclusion, the Congressional Budget Office has long stressed the importance of bringing the Federal deficit under control. Large Federal deficits crowd out capital investment, raise interest rates, and restrict economic growth. If non-interest spending exceeds tax revenues, growing federal deficits will eventually lead to rapidly rising federal interest costs, unsustainable increases in the federal debt, and a reversal in the long-term trend of rising living standards in the United States.

The Administration's new budget proposal represents a significant step toward limiting the rise in federal deficits and debt. CBO estimates that if the plan's targets were met, the budget deficit would remain roughly constant in nominal terms and would decline in relation to the size of the economy.

Although the plan would not produce a balanced budget, it would, if carried out, start to move federal fiscal policy off its present, unsustainable course.

The uncertainties involved in budget projections are legion, and small differences in estimating assumptions can lead to large differences in the projected deficit five or 10 years into the future. Although the Administration's budget projections are somewhat more optimistic than those of CBO, they fall within the range of plausible outcomes.

The 20-year history of Congressional budget projections, however, suggests that the budget deficit is much more likely to exceed projections than to come in lower. It is CBO's view that erring on the side of caution increases the likelihood that a balanced budget will actually be achieved in the time desired.

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Thank you. I would be happy to answer any questions.

[The prepared statement of Dr. O'Neill appears in the Submissions for the Record.]

Senator Mack. Thank you, Dr. O'Neill.

I think that the first question I would ask is, first of all, do you see dangers in using OMB's numbers? And if so, what are the dangers that you see as a result of using those numbers?

Dr. O'Neill. As I have indicated, the tendency has always been to be overly optimistic about future budget deficits. That has been true of both the Administration and the Congressional Budget Office. But the Congressional Budget Office has always tended to be more conservative and cautious in its projections. There is, I believe, a sincere desire on the part of the Congress to reduce the deficit. If that desire is to come true, it seems much more prudent to us to face the true seriousness of the deficit situation. We believe that our numbers portray the picture more accurately than those of OMB.

Of course, given that these figures are all long-run projections, nobody can say for sure what will happen. But based on historical experience, projecting larger deficits into the future under current policy is likely to be more accurate than projecting smaller deficits. And given the size of the problem, it is more prudent to face up to it rather than not.

I would add that should we encounter an unexpected surplus, that would be a much more pleasant problem to deal with than if we encountered a much larger deficit than we had anticipated.

Senator Mack. Again, let me rephrase what you said and see if you agree with it.

Basically, the risk is that by using numbers like OMB's, there's a tendency tc do less in deficit reduction.

Dr. O'Neill. That is exactly right.

Senator Mack. It might be so that you're making a great effort and the country may believe that that's a great effort, but the reality is you're going to come up short on the kinds of reductions that need to be made.

Dr. O'Neill. More than likely -- I think that is true.

Senator Mack. Okay. Let me ask one more question. Then I'm going to turn to Senator Grams.

The President -- or rather OMB -- estimates debt service savings lower deficits because of lower interest costs. The figure we've been looking at is like $477 billion over the next 10 years.

CBO estimates those savings to be only $187 billion over that same period of time.

Can you explain the difference?

Dr. O'Neill. I believe that it is not $477 billion in deficit reduction attributable to the so-called fiscal dividend.

Senator Mack. Take a whole combination of lower interest costs.

Dr. O'Neill. The amount of deficit reduction over the first seven years is about $477 billion. That is exactly right. Over the 10-year period, total deficit reduction is larger than that.

Senator Mack. I'm really -- again maybe you've got the numbers there -- I'm looking for the number that CBO has for -- we believe that the Administration is saying that over 10 years, there's something like $477 billion in lower interest costs, a combination of lower interest rates, lower deficits, bonuses.

If you add those together, it's about $477 billion.

CBO indicates that it's about $187 billion.

Dr. O'Neill. It was my impression that the $477 billion applied to the total deficit reduction. The accumulated deficit reduction, according to our estimates, that OMB is projecting under the President's budget would be $422 billion over seven years and about $1 trillion over 10 years.

But incorporated in those figures is a credit for a fiscal dividend that CBO had suggested would occur on a budget path going to zero. The appendix to our report on re-estimating the President's budget indicated that for a deficit reduction path that brought the deficit to zero in seven years, a fiscal dividend of about $170 billion in budget savings would be realized. But that number was based on starting from a much higher point. So the amount of deficit reduction that would actually have to occur is not $422 billion but $1.9 trillion which is a big difference.

In CBO's baseline estimates, the deficit in 2005 is more than 3 percent of the gross domestic product and would involve a reduction from more than 3 percent down to zero. The Administration is starting from a lower baseline and is not getting to zero in the seven-year period. They get to zero, according to their calculations, within a 10-year period.

But even so, the amount of deficit reduction is not as great because they are starting from a smaller percentage of GDP.

Senator Mack. Now you indicate that this fiscal dividend of $170 billion, in essence, CBO gave credit for that because, in fact, there was --

Dr. O'Neill. CBO did not give a credit for the dividend to the Administration's plan. The credit is for a path that genuinely brings the deficit down from more than 3 percent to zero over a seven-year period.

Senator Mack. And you did not give that to the President's proposal? Why?

Dr. O'Neill. Because it does not incorporate that much deficit reduction. The amount of deficit reduction is half of the amount that would be required to reduce the deficit from more than 3 percent of GDP down to zero.

It is a smaller deficit reduction so we could not give very much credit for it.

Senator Mack. And it's a smaller deficit reduction that, in CBO's opinion, does not get to zero at the end of 10 years.

Dr. O'Neill. It does not get to zero. But another factor is the sheer dollar volume of deficit reduction.

The Administration, in other words, is saying that the problem is smaller to begin with and therefore, it is not necessary to have such significant deficit reduction. And if, in fact, the deficit would be coming down under current policy, as the Administration projects, then much of the fiscal dividend would already have occurred under current policy. Whatever the forces were that had been leading the deficit to decline, as the Administration is projecting, would have implicitly reduced interest rates already. And that implicit decrease would be in the interest rates that are part of the package of economic assumptions. So according to the Administration, they have already gone much of the way toward reducing the deficit and therefore do not have to take much of an additional step.

It is still a big step, but it is certainly not as big a step as CBO believes is required.

Senator Mack. Very good.

Senator Grams?

Senator Grams. Thank you very much, Mr. Chairman. I only have about a minute or so with Dr. O'Neill, but a couple of quick questions that struck me.

First, I think you said it's basically about the same plan, Clinton II compared to Clinton I, only longer.

Dr. O'Neill. No, the first budget, the regular budget submission --

Senator Grams. Those are rosier assumptions.

Dr. O'Neill. The assumptions are identical. I believe that the Administration's baseline has not changed. It is the same baseline that was submitted as part of the original budget. However the original budget contained no significant policy changes that would have moved the nation toward deficit reduction. The June plan does.

Senator Grams. I thought he said it did. But go ahead.

Dr. O'Neill. Pardon?

Senator Grams. I thought he said it had, but go ahead.

Dr. O'Neill. Well, the original budget would have saved $30 billion over a five-year period, but that reduction is quite tiny and would have no appreciable effect on the deficit.

Senator Grams. Yes. Right. Now, the assumption under OMB is projecting very rosy economic growth, as you have mentioned.

When Alan Greenspan, the Chairman of the Federal Reserve, in testimony earlier this week in front of the Banking Committee said that this quarter, we're teetering on a negative, possible negative growth.

Where is the assumption or the optimistic numbers that the President can lay this budget on top of very optimistic economic assumptions in growth?

Dr. O'Neill. One such number is a projection of economic growth over a long period of time. The expectation is that the slowdown that we appear to be experiencing now will be short-lived. I think most people who are looking at the economic scene right now anticipate a brief slowdown and some bouncing back -- if not by the end of the year, then certainly by next year. The difference in assumptions about long-run growth between the Administration and CBO is not large.

Senator Grams. But you compound them.

Dr. O'Neill. When compounded, they become large. In the first five years, it is a difference of about 0.2 percent, which sounds small but would accumulate. The differences narrow in the latter part of the period to 0.1 percentage point a year.

I would not characterize the Administration's position as a wild assumption. It is certainly within the range of what one would consider possible outcomes.

Senator Grams. You said something in your opening statement that the Administration's revised budgetary plan for fiscal years '96 through 2005 included additional reductions in spending and increases in taxes.

Does the President's plan have some increases in taxes when he's talking about --

Dr. O'Neill. No, there is a net reduction in taxes. But doing away with corporate welfare involves increases in corporate taxes, taking away certain kinds of tax preferences. But there is no large tax increase. I am sorry if I gave that impression because, in fact, the Administration has proposed a tax cut. The net effect is a tax cut.

Senator Grams. Before I go on, would you take such a budgetary plan to any business and ask them to invest a couple of trillion dollars in this?

Dr. O'Neill. Well --

Senator Grams. I know, the taxpayers can bear this, but could a business make a profit on this and come out with a budget that could produce zero deficits?

Dr. O'Neill. The plan itself has only been sketched out. As yet, there are no policies specified, which is why we essentially accepted the Administration's estimates of the savings that would occur. Until we actually see a budget such as the one submitted in February, which is a detailed budget, we can not really estimate it. All the details have to be filled in before it would be possible to say whether this budget would actually accomplish what it says it would.

What it says it would do, by our estimates, would not bring the budget to balance after 10 years, and that is a problem. Obviously, CBO believes, and I believe, that the CBO estimates are more prudent and closer to what is likely to happen. But again, over 10 years, nobody can really say for sure what will happen.

Senator Grams. I know. But when you're spending your own money, I think you make more of the conservative assumptions, rather than the wilder assumptions. And I don't think a small business could invest a lot of money in a plan like this, let alone the largest business in the world, and that's the U.S. Government, investing taxpayer dollars under this plan.

Dr. O'Neill. Of course, the details matter. You would have to see what was actually in the proposals before you could assess whether they would generate the savings that have been anticipated.

Senator Grams. Thank you, Dr. O'Neill. I appreciate it.

Senator Mack. Thank you, Senator Grams.

I only have a comment or two more and then we'll conclude the hearing.

I'd like for you, if you would, to go back and look at the numbers that I referred to a few minutes ago about this $477 billion.

The way I looked at the President's proposal, over a 10-year period, the total debt service reduction, the debt service reduction over a 10-year period amounts to $477 billion.

Dr. O'Neill. My staff tells me that I misunderstood what you were asking.

Senator Mack. I thought so, yes.

Dr. O'Neill. I thought you were referring just to the fiscal dividend. But it is the reduction in total interest costs, that is, the payment to service the federal debt.

Senator Mack. Right.

Dr. O'Neill. The Administration has projected the $477 billion that you refer to. And CBO's estimate for debt service is $185 billion. The difference occurs because CBO estimates that the Administration has larger deficits. Therefore, there would be larger interest costs associated with the Administration's deficit reduction package.

Senator Mack. So you agree that the number that I used a few minutes ago, $477 cumulative debt service reduction, as stated by OMB, is $477 billion.

Dr. O'Neill. Yes. The Administration is projecting savings in debt service of $477 billion.

Senator Mack. Okay.

Dr. O'Neill. CBO projects $185 billion. The difference of $292 billion over the 10-year period is the fiscal dividend on account of lower interest rates.

Senator Mack. Yes. They basically took $170 billion that you had projected under the proposal --

Dr. O'Neill. For the seven-year period and added to it.

Senator Mack. -- and extended it to 10 years.

Dr. O'Neill. Right.

Senator Mack. And again, they count $292 billion of deficit reduction, this fiscal dividend, if you will, they count that as if they had balanced the budget.

And the point that I have made over and over again today is that the only way under their numbers that they can show a balanced budget is to use the dividend in order to get to a balance.

That makes absolutely no sense.

Dr. O'Neill. But even if the budget was being balanced, starting from a lower bar means your deficit is not very large to begin with, and the fiscal dividend is not going to be as large. It can't be.

Going from 3 percent plus of the gross domestic product, a deficit that large, to zero is a very large reduction in a deficit. But if you think that the deficit is 2 percent or less of the gross domestic product, then you do not have very far to go. Therefore, even if you went to zero, you could not claim such a large fiscal dividend because you have already taken the fiscal dividend into account in what you expect to happen anyway.

The subject, unfortunately, is somewhat difficult to articulate because of all the different concepts.

Senator Mack. Right. I understand. And my final point that I would make with respect to all of these numbers, and talk about numbers can make people's eyes start to glaze over...

But what is amazing about the Administration's plan, again, according to the way we are looking at it, is that they have spending reductions -- that is, net spending reductions, and that's also calculating in the effect of some tax cut proposals that they have in here. But the net spending reduction over the 10-year period is about $750 billion.

Their interest reduction that they claim is $477 billion. There's just absolutely no way that can happen. And I think that we've made a pretty good case here this morning that the President's plan is based on some rather faulty and shaky economic assumptions.

Now I would like to introduce Robert Reischauer's statement into the record and thank you for your testimony this morning.

Dr. O'Neill. It is a pleasure to be here.

Senator Mack. The hearing is adjourned.

[Whereupon, at 11:10 a.m., the hearing of the Joint Economic Committee was adjourned.]

SUBMISSIONS FOR THE RECORD

PREPARED STATEMENT OF SENATOR CONNIE MACK, CHAIRMAN

Good morning. Let me begin by saying that I commend the President's decision to join Congress's efforts to achieve a balanced budget. President Clinton's willingness to work toward a balanced budget signals an important shift in the way Washington has dealt with this issue over the last several years. At long last, both the Executive and Legislative branches appear to share the same goal. For those of us who have been committed to a balanced budget, that scenario is almost too good to be true. In a few ways it may be. I'm referring, of course, to the figures upon which the President bases his budget savings.

Two years ago, before a joint session of Congress, President Clinton stressed the significance of using, in his words, "the independent numbers of the Congressional Budget Office." Let's look at what the President had to say:

[Start video, 30 second delay for press cameras to focus-in on the TV, Clinton explaining, quote: I'll point out that the Congressional Budget Office was normally more conservative in what was going to happen and closer to right than previous presidents have been. I did this so that we could argue about priorities with the same set of numbers. I did this so that no one could say I was estimating my way out of this difficulty. In the last twelve years, because there were differences over the revenue estimates, you and I know that both parties were given greater elbow room for irresponsibility...Let's at least argue about the same set of numbers so the American people will think we're shooting straight with them."]

It's difficult to argue with the President's logic in those statements. What is confusing and perhaps somewhat disturbing, is why the President chose to abandon his own pledge. Why did he change philosophies halfway into his Administration? What is contained in this recent budget that can't stand up to CBO scrutiny?

There must be something, because in fact, the CBO said last Friday that the President's new ten year budget would produce cumulative deficits over 10 years exceeding $2 trillion. These figures are much different than the President's analysis. The first difference is in the economic assumptions which cause the President's estimates of future deficits to be much lower than the CBO's. But it's not just a problem of GDP growth rates. The President's budget also relies on a fiscal bonus calculated by the CBO that forecasts lower interest rates.

However, the CBO says that you're not entitled to the fiscal bonus until you've balanced the budget. With the Administration's plan, you CAN'T balance the budget unless you use this bonus. That's clever, but it's wrong. Republicans in Congress don't rely on the bonus to get to balance, we do it by cutting spending and making tough choices.

As I look over at Alice Rivlin, who is held in such high esteem for her longstanding commitment to deficit reduction, I have to wonder, how do you really regard this latest effort by the President? It seems that you, as the very first director of the Congressional Budget Office, would want the Administration's numbers to line up with the CBO. -- You certainly must have advised the President to honor his commitment to use CBO numbers? Why did the President change his mind?

Robert Reischauer, another former head of the CBO and well respected by the Administration, has submitted a statement to the Committee this morning in which he writes, quote, "Prudence suggests that the Congress should stick with CBO estimates of the size of the problem if it believes that it is important that the budget plan it adopts be viewed as one with reasonable, but by no means certain, chance of eliminating the deficit by the target year."

Some in the Administration have argued that the differences between CBO estimates and OMB estimates are minimal, that two-tenths of a percentage point in economic growth doesn't amount to much over ten years. Well, let me tell you what that amounts to -- $1 trillion in higher deficits. There's no tax payer in America, including myself, who thinks that $1 trillion is minimal.

This isn't just a question of rosy scenarios and technical estimates. It's a question of being too clever and simply looking for shortcuts to avoid real decisions and tough choices. Sure it's tempting to define away the problem with optimistic growth numbers and clever use of the "bonus." But the President was right in 1993 when he said we should shoot straight with the American people. I wish he would now.

There are enough honest differences in this debate without creating new ones. So while the Administration has come a long way in embracing the concept of a balanced budget which includes tax relief and less government spending, there is a credibility gap with the numbers behind the budget. The bottom line is, when we talk about the budget, we're not just playing with numbers, we're playing with everyone's future. Let's not play with a marked deck, let's work together and play straight with the American people, just like the President suggested two years ago.

TESTIMONY OF
ALICE M. RIVLIN
DIRECTOR, OFFICE OF MANAGEMENT AND BUDGET
BEFORE THE
JOINT ECONOMIC COMMITTEE

June 22, 1995

Two years ago, responsible observers universally foresaw growing federal deficits. With no source of relief in sight, the likely outcome was an explosion of debt and a mounting debt burden.

The most serious implication of growing deficits was the likelihood of continued sluggish growth in the living standards of average American families. With a large deficit draining our nation's saving, the outlook for business investment was poor. Without strong investment, productivity would lag, dampening long-term economic growth and average wages.

From the start, this Administration has taken on difficult fights to improve the nation's well-being in the long run, even if they offered little political reward in the short run. In debates over the North American Free Trade Agreement (NAFTA) and the Uruguay Round of the General Agreement on Tariffs and Trade (GATT), which will cut trade barriers and enhance competition, the President confronted those who prefer the security of the status quo. He knew that, over time, everyone would reap the benefits of lower tariffs with our trading partners even if, in the near term, more competition could cause some pain. He won and, though it is not yet widely appreciated, we already can discern an economic payoff coming in the years ahead.

The deficit problem was similar in nature. In 1993, the President proposed and Congress passed a major deficit reduction plan. While freezing overall appropriations, the plan shifted priorities, putting more resources into programs that -- like investments in the private sector -- build our nation's productive capacity for the future. These efforts do not replace the private sector's leading role in generating growth. What they do, however, is give the private sector the tools -- well-prepared workers, infrastructure, and basic scientific and technical knowledge -- that it cannot generate for itself. Over two years, Congress has approved shifts of about $17 billion into these investments.

The benefits of our deficit reduction plan are already clear. The deficit has fallen even more than we originally estimated; in fact, over 7 years, we now estimate that the accumulated deficits will fall by more than $1 trillion. The economy also responded far beyond our forecasts. Though some observers predicted job loss and even recession, the economy has grown more rapidly over a longer period than at any time in recent memory. Interest rates fell sharply, spurring an investment boom. With lower interest rates, households and businesses refinanced debt and shored up balance sheets. Rapid economic growth prompted a burst of job creation -- more than 6,000,000 so far, over 90 percent in the private sector. At the same time, inflation hit bottom and stayed there. Federal Reserve Chairman Alan Greenspan said that prospects for sustained, noninflationary growth are the best in more than a generation.

Clearly, the President's plan is the base on which the President and Congress will build future policy. Without the plan, which no Member of Congress in either party proposes to repeal, no plan on the table today would have any chance to balance the budget in the foreseeable future.

Our long-run deficit outlook has improved greatly, with the nation now projected to carry $1 trillion less debt by the year 2000. In several years, however, the deficit will start to rise again -- for just the reason the President pinpointed even before he took office: rising health care costs. That is why, in his State of the Union message in January and his budget in February, he pledged to work with Congress to develop a new, more incremental approach to health care reform. The President viewed health reform and other savings in entitlements as the next and final step to put the problem of budget deficits behind us.

The President's 10-Year Plan

The House and Senate have adopted separate plans to balance the budget, and a House-Senate conference committee is working to iron out a final plan. We share their goal, but we have grave concerns about their means. As the President has often said, there is a right way and a wrong way to balance the budget. Unfortunately, the House and Senate resolutions would do it the wrong way.

Those resolutions seek to reach balance by the apparently arbitrary date of 2002. The House resolution made the job of balancing the budget even harder by proposing a huge tax cut whose benefits would flow disproportionately to people who simply do not need it. The Senate has penciled in a smaller, but similar, tax cut on a contingency basis. The House and Senate then cut spending deeply to reach balance.

That is the wrong way. Because of the haste to reach balance, and because the tax cuts are too big and go to the wrong people, the House and Senate would sacrifice important national priorities, including Medicare and Medicaid. The Medicare cuts specified by the House would bear unfairly on the low- and moderate-income elderly, and could severely affect the quality of care. The House and Senate Medicaid cuts reach far beyond levels that any reasonable policy can achieve. They would threaten the well-being of low-income Americans, including the indigent elderly and disabled in long-term care. In addition, they would reduce coverage of children and risk sending those without paid access into hospital emergency rooms, further burdening the overall health system with costs of uncompensated care.

Another victim of the House and Senate plans is education and training. In a knowledge-based economy, the fortunes of workers depend on education and training. We must not attempt to balance the budget at the expense of skills and knowledge. That strategy would contradict the whole purpose of balancing the budget: raising the standard of living for average Americans in the long run.

The federal role in education is limited but important. The federal government takes responsibility for preschool education for the disadvantaged, some of the particularly expensive services needed in elementary and secondary education (e.g., special and compensatory education), and, more broadly, for the finance of higher education for the low- and moderate-income population.

Absent this role, children from low-income families would enter school less well-prepared, and local school districts would face the costs of special programs.. In particular, the risk of accumulating interest-bearing debt while in college could easily deter low-income high school graduates from attending. This risk would pull a rung from what should be a ladder of opportunity. We must continue to prepare our youth to participate fully in our economy. The House and Senate resolutions put our progress in education at unnecessary risk.

The President's balanced budget proposal differs from the House and Senate plans in two important ways. First, we did not choose a date for balance and then force our policies to meet it; we chose policies first, then let the date flow from them. Second, we did not include a large tax cut for people who do not need it. Instead, we again proposed the more affordable tax cut in the President's February budget, targeted especially to the education and training needs of middle-class Americans.

The spending cuts in the President's 10-year plan come in four main areas.

1. **Discretionary appropriations.** In this category, we are continuing the restraint in the President's FY 1996 budget, with savings of $201 billion over seven years and $460 billion over 10. These savings involve every area of discretionary spending aside from a few selected priority programs, for which the President focuses federal resources to have the greatest impact on the living standards of average Americans and long-term economic growth. These include education and training, where the President provided full protection for inflation; children; a small number of science and technology research priorities, including biomedical and behavioral research at the National Institutes of Health; crime-fighting, with full funding of the Violent Crime Reduction Trust Fund; and environmental protection, with consolidation of the Clean Water and Safe Drinking Water State Revolving Funds.

Education is perhaps the President's top priority in this budget. He provides full inflation protection for National Service, the GI Bill for America's Workers, and Goals 2000. He provides enough funds for Pell Grants to keep up with inflation and serve the growing student population. And he emphasizes his new, more efficient programs -- not the more intrusive, bureaucratic efforts of the past.

Other programs will feel continued restraint under the Vice President's effort to reinvent government -- which has cut federal employment by over 100,000 full-time equivalents (FTE) on the way to cutting 272,900 FTE by 1999. Since December, the President and Vice President have announced the restructurings of numerous agencies. They not only produce budget savings but also show how to improve government operations.

2. Health care. In this category, the President has proposed steps to save funds in Medicare and Medicaid, along with the first, serious steps toward health care reform -- including insurance reform, to help people keep their coverage when they get sick or change jobs, and subsidies to help working families keep their coverage when they lose jobs.

For savings in Medicare, the President proposes measured cuts -- half or less than those in the Senate and House resolutions -- which bear solely on providers. These cuts will extend the solvency of the Medicare Hospital Insurance trust fund by at least three years (to 2005), according to the career actuaries at the Health Care Financing Administration (HCFA).

For Medicaid, the President proposes to cut spending by $54 billion over seven years, $105 billion over 10. His cuts are about a third of those proposed by the Senate, and about a fourth of those proposed by the House. We want to maintain the coverage that Medicaid provides to so many low-income working Americans, children, and senior citizens, while increasing state flexibility. The House's cuts are particularly hard to justify. The likely resulting loss of coverage for our low-income, elderly and disabled population would cause great hardship and eventually show up in hospital emergency rooms. Instead, the President proposes enhancing state flexibility to pursue managed-care and other service-delivery innovations; diminishing some federal requirements such as the Boren amendment that mandate what states must pay providers for services; better targeting of disproportionate share payments to hospitals; and limiting on a per-person basis the growth of payments -- not a block grant that, especially at the levels proposed by the House and Senate resolutions, would cost many beneficiaries their coverage.

The President continues to believe we should pursue Medicare and Medicaid savings only in the context of broader health reform. The President's health care reform proposal includes the elimination of the copayment for mammography, and the establishment of a respite care benefit, under Medicare; a home- and community-based care grant program for the elderly and disabled; a subsidy for extending insurance coverage for up to six months for workers who lose their jobs; the expansion of the health insurance tax deduction for the self-employed to 50 percent;

voluntary pooling options for the self-employed in insurance plans available under the Federal Employees Health Benefits Program (FEHBP); and various insurance and small-group reforms and consumer protections relating to portability and renewability of coverage.

3. **Welfare reform.** As you know, the President views welfare reform as a top priority. He unveiled a welfare reform proposal last year, and he refined the proposal in his budget. His proposal includes fraud and error controls, fair and measured restraints on benefits to aliens, encouragement for beneficiaries to move from welfare to work, and investments in the necessary child care and work programs. It maintains the nutritional safety net, targets support to the neediest, and protects poor children. We believe this program is far more sound than the House-passed proposal, which would purport to save more than twice as much but would tear apart the social safety net, impose unattainable work requirements, and at the same time cut funds for child care.

4. **Savings in other entitlements.** In this category, the President proposes measured restraints in veterans and farm programs, stressing greater efficiency and market-oriented choices for agriculture. In student loans, the President would speed the transition to direct lending, which cuts federal costs without imposing another burden on student borrowers or their families.

All told, the President's plan provides over $1.2 trillion of deficit reduction, bringing the budget to at least balance in 2005.

A Word About Assumptions

For his 10-year budget, the President used the OMB baseline as in his February budget. Administrations always put forward their baselines from which to measure their policies; since the start of the Congressional budget process, Congress chose to have an independent view of the baseline outlook. We have no quarrel with this function. But we must recognize that, with different experts considering so many variables, those assessments will invariably differ.

This year, OMB's differences with the Congressional Budget Office are relatively small -- as CBO itself has written. But these differences have received more attention than they deserve, for two reasons: First, for the first time, the President and Congress are focusing on very long horizons -- seven or 10 years -- and even small differences in budget estimates tend to compound over time. Second, and also for the first time, the President and congressional plans seek to reach the precise number of zero, so estimating differences are more prominent.

OMB-CBO differences over economic assumptions are quite small. For seven of the 11 years, 1995-2005, our forecasts of real economic growth are just 0.1 percentage point apart; for three other year, the gap is just 0.2 percentage points. Differences in other economic indicators are a bit larger, but mostly offset one another; OMB projects lower unemployment rates, which lower the deficit, but higher interest rates, which raise the deficit. As you know, the Senate and especially the House significantly modified the CBO economic assumptions in their resolutions; the assumptions they use are even closer to the Administration's than to CBO's.

CBO has written, "The economic assumptions of CBO and the Administration appear quite similar [*An Analysis of the President's Budgetary Proposals for Fiscal Year 1996*, p. 3] ... The Administration is generally closer than CBO to the *Blue Chip*'s [the consensus of private economic forecasters] long-range projections [*An Analysis*, p. 10]." Indeed, our projected deficits would be lower if we adopted the *Blue Chip* long-run economic forecast rather than our own.

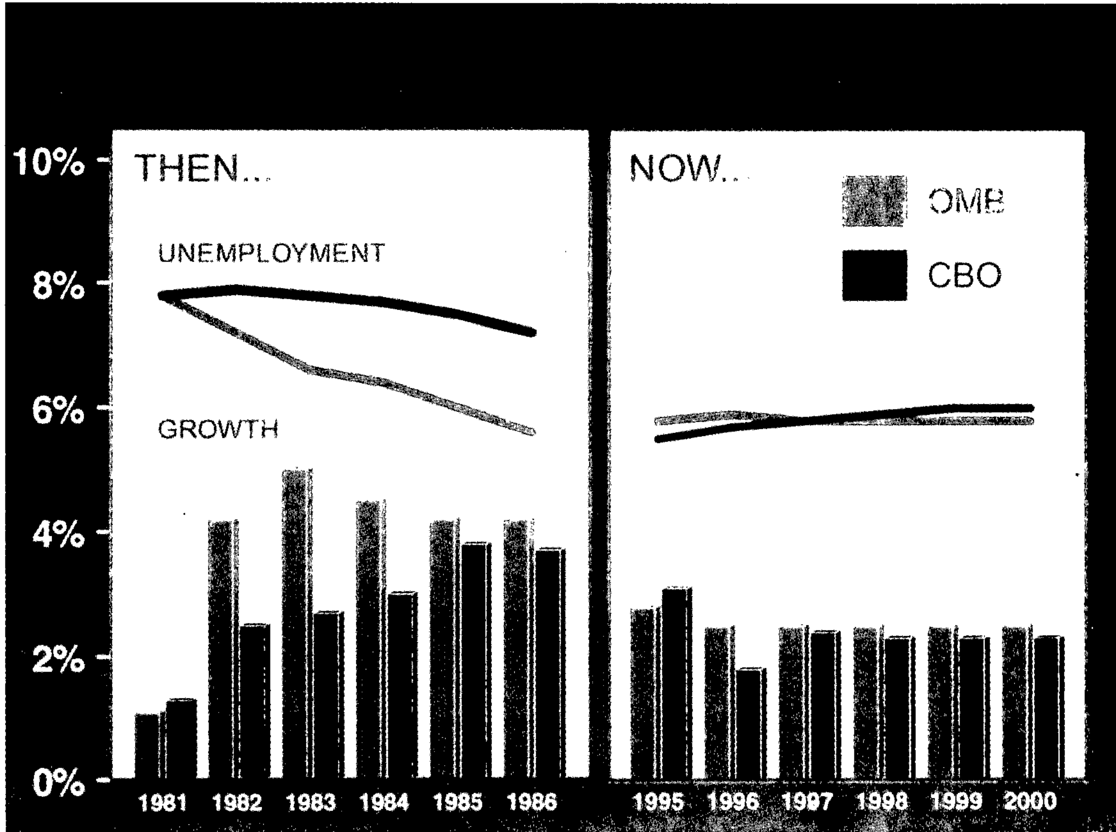
In 1993, the President used CBO's economic assumptions rather than his own in connection with his economic plan. He sought to take any dispute over economics off the table. Since then, we have used our own economic assumptions for presenting budgets and scoring enacted legislation. The reason is simple: We have restored the credibility that OMB's economic assumptions had lost under earlier Administration. Our projections have mirrored the mainstream of private forecasts, as the economics profession has recognized. Our deficit projections have been close to CBO's and have, if anything, underpredicted the success of the President's program. Forecasting is a perilous profession, and precise accuracy is beyond the reach of mortal man, but this Administration has earned its reputation as reasonable and prudent.

Our assumptions for health care costs are also very close to CBO's. As you know, this Administration (like those before it) uses the projections of the career actuaries at HCFA. Both HCFA and CBO anticipate that Medicare and Medicaid spending growth will slow. HCFA projects a somewhat more pronounced slowdown. For Medicare Part A, CBO projects cost growth of 7.9 percent over the next 10 years; HCFA projects 7.5 percent. For Medicare Part B, CBO forecasts 12.3 percent growth; HCFA projects 11.3 percent. For Medicaid, CBO expects 9.9 percent growth; HCFA forecasts 9.3 percent. In the words of CBO, "Given the size of those two programs and the uncertainty about their future costs, the projections of CBO and the Administration are not very far apart [*An Analysis*, p. 5]."

Conclusion

The President's program builds on his success in cutting the deficit. It takes a responsible, reasonable approach, proposing spending reductions on a scale that is attainable and consistent with the purpose of deficit reduction: raising the living standards of average Americans in the long run.

The budget debate is heated, with strong opinions on both sides. The rapid responses of some observers suggest again that the President's proposal, as a reasoned and responsible approach to the problem, will take fire from those who believe that there is always an approach that is quicker, simpler, and more gratifying in the short run. But in the final analysis, I believe the President's plan will be seen to be in the nation's best interests over the long haul.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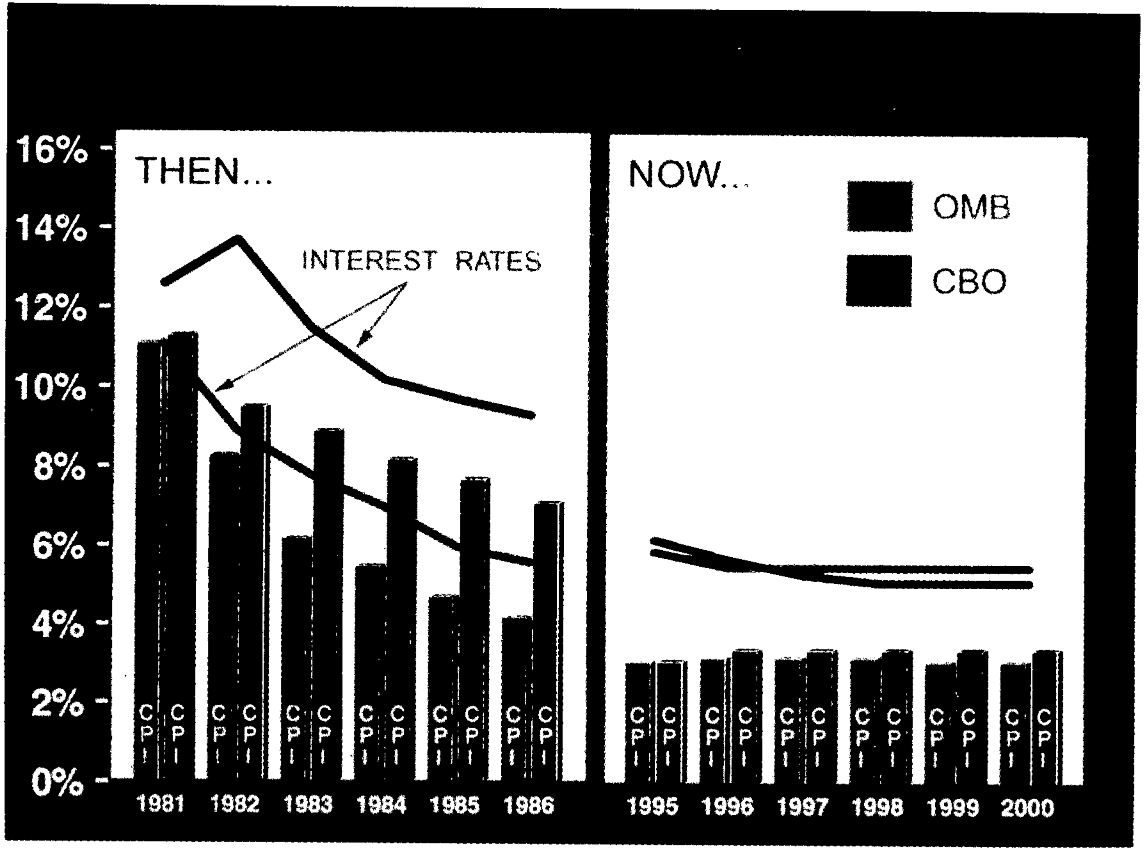

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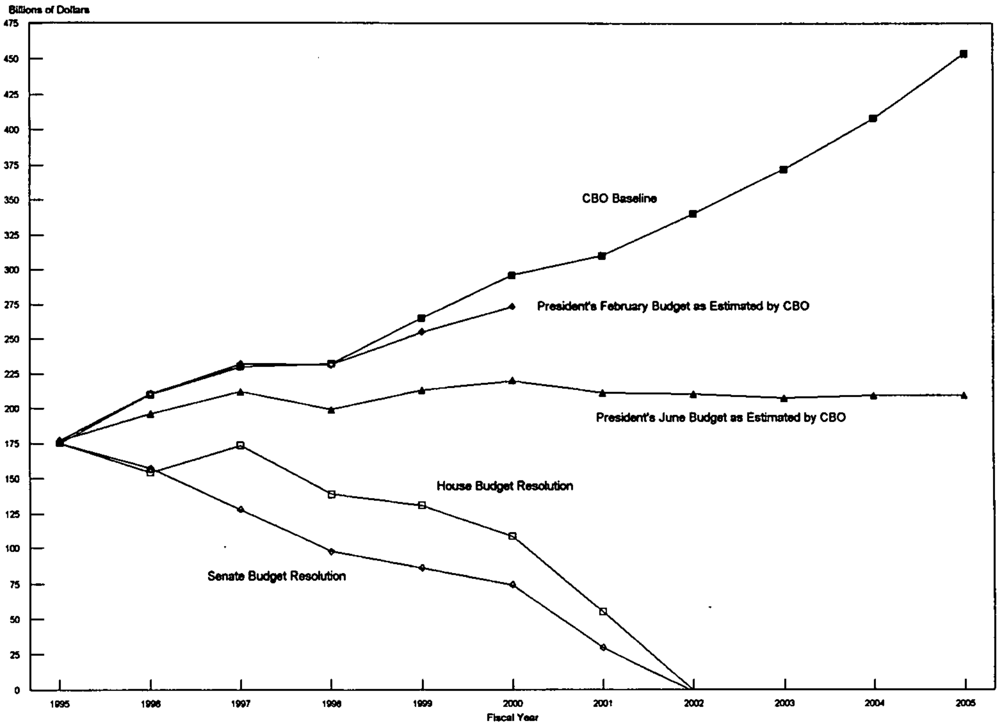
Chairman Mack, Congressman Saxton, and Members of the Committee, I am pleased to be with you this morning to review the budgetary plan that the Clinton Administration released on June 13. The budget that the Administration submitted in February for fiscal years 1996 through 2000 would not have substantially changed the projected budget deficits. By contrast, the Administration's revised budgetary plan for fiscal years 1996 through 2005 includes additional reductions in spending and increases in taxes designed to make large reductions in the federal deficit (see Figure 1). In my statement today, I will describe the Congressional Budget Office's (CBO's) preliminary assessment of the Administration's new plan and explain the differences between CBO's estimates and those of the Administration.

THE ADMINISTRATION'S BUDGETARY PLAN

The budget submitted by the Administration in February recommended changes in policies that would have reduced the cumulative deficit by about $30 billion between 1995 and 2000. The President proposed tax changes that would shrink revenues by $60 billion over the six-year period. The major tax initiative would provide for tax relief in the form of a nonrefundable tax credit for families with young children, a deduction for postsecondary education and training expenses, and expansion of individual retirement accounts. Proposed savings in Medicare (stemming primarily from extending provisions of the Omnibus Budget Reconciliation Act of 1993 that expire at the end of 1998) and other mandatory programs offset only about $17 billion

FIGURE 1. COMPARISON OF PROJECTED DEFICITS



SOURCE: Congressional Budget Office

of the revenue loss. The President also proposed to sell assets that CBO estimated would produce almost $8 billion in receipts. Finally, compared with CBO's baseline, which allows for inflation in discretionary programs after 1998, the President's budget would have reduced discretionary spending by a cumulative total of $67 billion, with most of the reductions occurring in 1999 and 2000.

The President's June budgetary plan retains most of the elements of the February budget. In addition, it extends the fiscal horizon through 2005 and assumes additional savings intended to achieve budget balance in 10 years. The major new areas targeted for reduction are:

- o Discretionary spending--$112 billion in cuts in 2005 and $505 billion in cumulative reductions over the 1996-2005 period compared with CBO's baseline with discretionary inflation after 1998;

- o Medicare--$67 billion in 2005 and $295 billion over the 1996-2005 period;

- o Medicaid--$19 billion in 2005 and $105 billion in total;

- o Welfare programs--$9 billion in 2005 and $63 billion in total; and

- o Corporate subsidies--$6 billion in 2005 and $43 billion in total.

The Administration's June package also contains several health initiatives. In addition to providing for spending reductions in Medicare and Medicaid, the Administration proposes a number of new benefits, including subsidies of health insurance for people unemployed up to six months, grants to states for home- and community-based long-term care, an Alzheimer's respite care benefit within Medicare, and elimination of the copayment for mammograms. The Administration would also increase the fraction of health insurance costs that the self-employed can deduct for income tax purposes from 30 percent to 50 percent.

As explained by the staff of the Office of Management and Budget (OMB), the additional budgetary savings included in the Administration's new plan are "indicative proposals" that as of yet do not represent specific policies. Therefore, a detailed program-by-program evaluation of the President's June budget is not possible now. Relying on the Administration's estimates of the proposed savings, however, CBO has prepared a preliminary assessment of the budgetary effect of the President's new plan.

CBO estimates that the President's June budget plan would hold the total deficit to about $200 billion a year if the plan's assumptions were translated into specific policies (see Tables 1 and 2). For comparability with the budget resolution, CBO has adjusted its baseline deficit to reflect the projected effects on mandatory spending and revenues of rebenchmarking the consumer price index (CPI). In 1998,

TABLE 1. PRELIMINARY ASSESSMENT OF THE PRESIDENT'S BUDGETARY PROPOSALS (By fiscal year, in billions of dollars)

	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	1996-2002	1996-2005
CBO Baseline Deficit with Discretionary Inflation After 1998[a]	210	230	232	266	299	316	349	384	422	472	n.a.	n.a.
Adjustment for Rebenchmarking of the Consumer Price Index	0	0	0	-1	-3	-6	-10	-12	-14	-18	n.a.	n.a.
Adjusted Baseline Deficit	210	230	232	265	296	310	340	372	408	454	n.a.	n.a.
President's Budgetary Proposals[b]												
Discretionary spending	-5	-8	-16	-30	-45	-53	-62	-79	-94	-112	-219	-505
Mandatory spending												
Medicare	-4	-6	-10	-16	-23	-30	-39	-45	-55	-67	-128	-295
Medicaid	-4	-4	-6	-7	-9	-11	-13	-15	-17	-19	-54	-105
Poverty programs	-2	-4	-5	-6	-6	-7	-8	-8	-8	-9	-38	-63
Other	-2	-2	-1	3	3	3	-2	-2	-2	-1	2	-3
Subtotal	-11	-16	-22	-26	-35	-46	-62	-70	-82	-95	-218	-465
Revenues[c,d]	3	10	11	14	18	20	21	21	25	23	97	166
Corporate subsidies[d]	-1	-2	-3	-4	-5	-5	-5	-6	-6	-6	-25	-43
Debt service[e]	-1	-2	-3	-6	-10	-15	-22	-31	-42	-55	-57	-185
Total Changes	-14	-18	-33	-52	-77	-99	-130	-165	-199	-246	-422	-1,031
Deficit Under the President's Budgetary Proposals	196	212	199	213	220	211	210	207	209	209	n.a.	n.a.

SOURCES: Congressional Budget Office; Office of Management and Budget.

NOTES: Numbers may not add to totals because of rounding. n.a. = not applicable.

a. Assumes compliance with discretionary spending limits through 1998. Discretionary spending is assumed to increase at the rate of inflation after that.

b. Discretionary savings equal the difference between CBO's baseline discretionary spending and the levels of discretionary spending specified in "The President's Economic Plan," released June 13, 1995. Mandatory spending savings and revenue changes are at the levels specified in the President's plan. CBO has not reestimated the savings because there is not sufficient detail available at this time to allow a reestimate.

c. Excludes estimated loss of revenues from the Federal Reserve as a result of the Administration's anticipated reduction in interest rates.

d. Revenue losses are shown as positive because they increase the deficit.

e. Debt service represents CBO's estimate of the reduction in interest payments that would result directly from the noninterest savings shown in this table. It does not include any possible effect from lower interest rates that might result from lower deficits.

TABLE 2. PRELIMINARY ASSESSMENT OF BUDGETARY ESTIMATES UNDER THE PRESIDENT'S POLICIES
(By fiscal year, in billions of dollars)

	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005
Outlays										
Discretionary										
Defense	262	258	255	260	268	276	281	282	283	283
Nondefense	285	287	286	284	281	286	293	297	303	308
Subtotal	547	545	541	545	550	562	574	579	586	591
Mandatory[a]										
Medicare[b]	175	191	206	221	238	257	276	303	329	357
Medicaid	95	106	116	128	139	152	165	179	195	213
Other	534	567	597	637	675	702	735	773	813	860
Subtotal	805	865	919	986	1,051	1,109	1,176	1,255	1,337	1,431
Net interest[c]	260	270	278	290	304	314	327	340	353	365
Total	1,612	1,680	1,738	1,822	1,905	1,985	2,077	2,174	2,276	2,388
Revenues[d]	1,416	1,467	1,538	1,608	1,685	1,774	1,868	1,967	2,066	2,179
Deficit Under the President's Budgetary Proposals	196	212	199	213	220	211	210	207	209	209
Deficit as a Percentage of GDP	2.7	2.7	2.4	2.5	2.4	2.2	2.1	2.0	1.9	1.8
Memorandum:										
Gross Domestic Product	7,370	7,747	8,152	8,572	9,013	9,483	9,978	10,499	11,047	11,623

SOURCES: Congressional Budget Office; Office of Management and Budget, "The President's Economic Plan," released June 13, 1995.

NOTES: Numbers may not add to totals because of rounding.

a. Projected mandatory spending is based on the Administration's estimates of savings from a current-policy baseline. CBO has not reestimated the savings because there is not sufficient detail available at this time to allow a reestimate.

b. Includes receipts from Medicare beneficiary premiums as offsets to Medicare spending.

c. Net interest projections are based on CBO's estimate of the reduction in interest payments that would result directly from the noninterest savings shown in this table. They do not include any possible effect from lower interest rates that might result from lower deficits.

d. Projected revenues are based on the Administration's estimates of changes from a current-policy baseline. CBO has not reestimated the changes because there is not sufficient detail available at this time to allow a reestimate. The projections exclude the estimated loss of revenues from the Federal Reserve associated with the Administration's anticipated reduction in interest rates.

the weights of the various categories of consumption in the CPI will change from the current 1982-1984 basis to a 1993-1995 basis. The budget resolutions passed by the House and Senate assume that this change will reduce the growth of the overall CPI by about 0.2 percentage points a year compared with CBO's winter economic assumptions.

Because of the different budgetary rules governing discretionary and mandatory programs, CBO has used different methods for estimating the savings in the two budgetary categories. For defense and nondefense discretionary spending, CBO's estimate assumes the level of outlays specified in the President's plan. The estimated discretionary savings equal the difference between the level of discretionary spending in CBO's baseline and that in the President's plan. Because CBO's baseline for those programs is higher than the Administration's baseline, CBO's estimates of the amounts of discretionary savings are larger than the Administration's savings figures. For mandatory spending programs and revenues, CBO's preliminary assessment assumes that the net changes from the baseline equal those specified by the Administration. The revenue changes differ from those shown by the Administration because they exclude a reduction in Federal Reserve earnings resulting from the Administration's assumed drop in interest rates. CBO has estimated the resulting amount of savings in debt service using the interest rates that underlie its April baseline.

Under those assumptions, the budget deficit under the President's policies would represent about 2 percent of gross domestic product (GDP) in 2005. By contrast, CBO's baseline deficit averages more than 3 percent of GDP over the 1995-2005 period. The reduction in the deficit under the President's policies would allow a modest drop in interest rates compared with those in CBO's baseline. Because of the uncertainties surrounding the President's plan and the estimates of its effects on the budget, CBO has not incorporated a drop in interest rates attributable to deficit reduction. But even if some allowance was made for that effect, the deficits under the President's June budget would probably remain near $200 billion through 2005.

DIFFERENCES BETWEEN CBO AND OMB ESTIMATES

In contrast to the deficit of $209 billion in 2005 estimated by CBO, the Administration projects that its policies would produce a budget surplus of $18 billion. What accounts for that difference of almost $230 billion between the two estimates?

First, in 2005 the Administration assumes more than $60 billion in additional savings from lower interest rates--the so-called fiscal dividend. As previously indicated, we believe that the Administration's plan would produce a much smaller fiscal dividend than OMB anticipated because we estimate that the amount of deficit reduction falls short of that needed to achieve budgetary balance by 2005.

Second, CBO's projected baseline deficit is much higher than OMB's. As shown in Table 3, CBO projects that the budget deficit under current policies will reach $454 billion in 2005, assuming that discretionary spending keeps pace with inflation after the discretionary spending limits expire in 1998. By contrast, OMB projects a baseline deficit of only $266 billion for 2005. Excluding differences in discretionary spending, CBO's projected baseline deficit exceeds OMB's by almost $170 billion.

Although the economic assumptions of CBO and the Administration appear quite similar, the differences are in fact sufficient to produce marked differences in budget projections that only grow with time. On average, the Administration foresees slightly faster economic growth than does CBO. Over the next five years, the Administration's average rate of growth of real GDP is 0.2 percentage points a year faster than CBO's. Also, CBO and the Administration differ in their projections of the growth of the CPI relative to that of the GDP deflator. CBO assumes that the CPI will grow significantly faster than the deflator, whereas the Administration assumes only slightly faster growth (see Table 4). Because the CPI affects indexed benefit programs and tax brackets, whereas the GDP deflator affects estimates of taxable income, CBO's assumption of a larger gap between the two growth rates adds to its projection of the deficit. Largely as a result of differences in economic assumptions, CBO's projection of revenues in 2005 is $62 billion below the Administration's.

TABLE 3. COMPARISON OF BASELINE PROJECTIONS (By fiscal year, in billions of dollars)

	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005
OMB Baseline											
Receipts	1,346	1,418	1,482	1,560	1,638	1,729	1,823	1,924	2,028	2,141	2,257
Outlays											
Discretionary[a]	554	555	556	557	573	590	607	625	644	663	683
Mandatory											
Medicare	154	175	192	209	228	249	273	298	326	357	392
Medicaid	88	96	105	115	125	136	149	163	178	194	212
Other	508	537	576	604	634	668	700	733	769	807	847
Subtotal	751	808	873	928	987	1,053	1,122	1,195	1,274	1,359	1,451
Net interest	234	257	271	284	300	315	329	344	359	374	390
Total	1,539	1,620	1,700	1,769	1,860	1,958	2,058	2,164	2,276	2,396	2,524
Deficit	193	201	218	209	221	229	235	240	248	255	266
Deficit as a Percentage of GDP (As reported by OMB)	2.7	2.7	2.8	2.5	2.5	2.5	2.4	2.3	2.3	2.2	2.2
CBO Baseline											
Receipts	1,355	1,418	1,475	1,546	1,618	1,698	1,789	1,884	1,982	2,085	2,196
Outlays											
Discretionary[a]	548	552	553	557	575	595	615	636	658	680	703
Mandatory											
Medicare	158	179	197	216	237	261	287	315	348	384	424
Medicaid	89	99	110	122	135	148	163	178	194	212	232
Other	499	538	573	603	640	678	706	745	783	823	870
Subtotal	747	816	881	941	1,012	1,086	1,155	1,238	1,325	1,419	1,526
Net interest	235	260	271	281	296	313	329	349	371	394	421
Total	1,530	1,628	1,706	1,778	1,884	1,995	2,099	2,223	2,354	2,494	2,650
Deficit	175	210	230	232	265	296	310	340	372	408	454
Deficit as a Percentage of GDP	2.5	2.9	3.0	2.8	3.1	3.3	3.3	3.4	3.5	3.7	3.9

(Continued)

TABLE 3. Continued

	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005
	Difference (CBO baseline minus OMB baseline)										
Receipts	9	-1	-7	-13	-20	-31	-34	-40	-46	-56	-62
Outlays											
Discretionary	-6	-3	-3	-1	2	5	8	11	14	17	20
Mandatory											
Medicare	4	4	6	7	9	11	14	17	21	26	32
Medicaid	1	3	5	8	10	12	13	15	16	18	20
Other	-9	1	-3	-1	6	10	6	12	14	16	23
Subtotal	-4	8	8	13	25	33	33	43	52	60	76
Net interest	1	3	b	-3	-4	-1	b	5	12	20	30
Total	-9	8	6	9	24	37	41	60	77	97	126
Deficit	-18	9	12	23	44	68	74	100	124	153	188
Deficit as a Percentage of GDP	-0.3	0.1	0.2	0.3	0.5	0.7	0.8	1.0	1.2	1.4	1.6

SOURCES: Congressional Budget Office; Office of Management and Budget.

NOTE: GDP = gross domestic product.

a. Assumes compliance with discretionary spending limits through 1998. Discretionary spending is assumed to increase at the rate of inflation after that.

b. Less than $500 million.

TABLE 4. COMPARISON OF ECONOMIC ASSUMPTIONS, CALENDAR YEARS 1995-2005

	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005
Nominal GDP (Billions of dollars)											
CBO	7,127	7,456	7,847	8,256	8,680	9,128	9,604	10,106	10,633	11,188	11,772
Administration	7,116	7,504	7,921	8,361	8,823	9,310	9,822	10,359	10,926	11,524	12,156
Real GDP (Percentage change, fourth quarter over fourth quarter)[a]											
CBO	2.5	1.9	2.4	2.3	2.3	2.3	2.3	2.3	2.3	2.3	2.3
Administration	2.4	2.5	2.5	2.5	2.5	2.5	2.4	2.4	2.4	2.4	2.4
GDP Deflator (Percentage change, fourth quarter over fourth quarter)											
CBO	2.8	2.8	2.8	2.8	2.8	2.8	2.8	2.8	2.8	2.8	2.8
Administration	2.9	2.9	3.0	3.0	3.0	3.0	3.0	3.0	3.0	3.0	3.0
Consumer Price Index (Percentage change, fourth quarter over fourth quarter)[b]											
CBO	3.2	3.4	3.4	3.2	3.2	3.2	3.2	3.2	3.2	3.2	3.2
Administration	3.3	3.2	3.2	3.2	3.1	3.1	3.1	3.1	3.1	3.1	3.1
Civilian Unemployment Rate (Percent)											
CBO	5.5	5.7	5.8	5.9	6.0	6.0	6.0	6.0	6.1	6.1	6.1
Administration	5.8	5.9	5.8	5.8	5.8	5.8	5.8	5.8	5.8	5.8	5.8
Three-Month Treasury Bill Rate (Percent)											
CBO	6.2	5.7	5.3	5.1	5.1	5.1	5.1	5.1	5.1	5.1	5.1
Administration, without fiscal dividend	5.9	5.5	5.5	5.5	5.5	5.5	5.4	5.3	5.2	5.1	5.0
Administration, with fiscal dividend[c]	5.9	5.4	5.2	5.0	4.8	4.6	4.5	4.3	4.1	4.0	3.9
Ten-Year Treasury Note Rate (Percent)											
CBO	7.7	7.0	6.7	6.7	6.7	6.7	6.7	6.7	6.7	6.7	6.7
Administration, without fiscal dividend	7.9	7.2	7.0	7.0	7.0	7.0	7.0	7.0	7.0	7.0	7.0
Administration, with fiscal dividend[c]	7.9	7.2	6.6	6.4	6.2	6.0	5.8	5.6	5.4	5.3	5.3

SOURCES: Congressional Budget Office, Office of Management and Budget.

a. Based on 1987 dollars.

b. Consumer price index for all urban consumers (CPI-U). CBO has adjusted its January projection to reflect a 0.2 percent decrease in CPI growth resulting from rebenchmarking beginning in 1998.

c. Includes the reduction in interest rates assumed by the Administration to result from the deficit reduction proposed in "The President's Economic Plan," released June 13, 1995.

Estimating differences unrelated to economic differences also contribute to CBO's estimate of the baseline deficit compared with the Administration's estimates. In 2005, $52 billion of the difference in projected spending can be traced to differences in projected spending in the Medicare and Medicaid programs alone. Although CBO believes that the growth of those programs has slowed from the extremely high rates of recent years, it is not quite as optimistic as the Administration about the extent to which such a slowdown would occur without a change in policy.

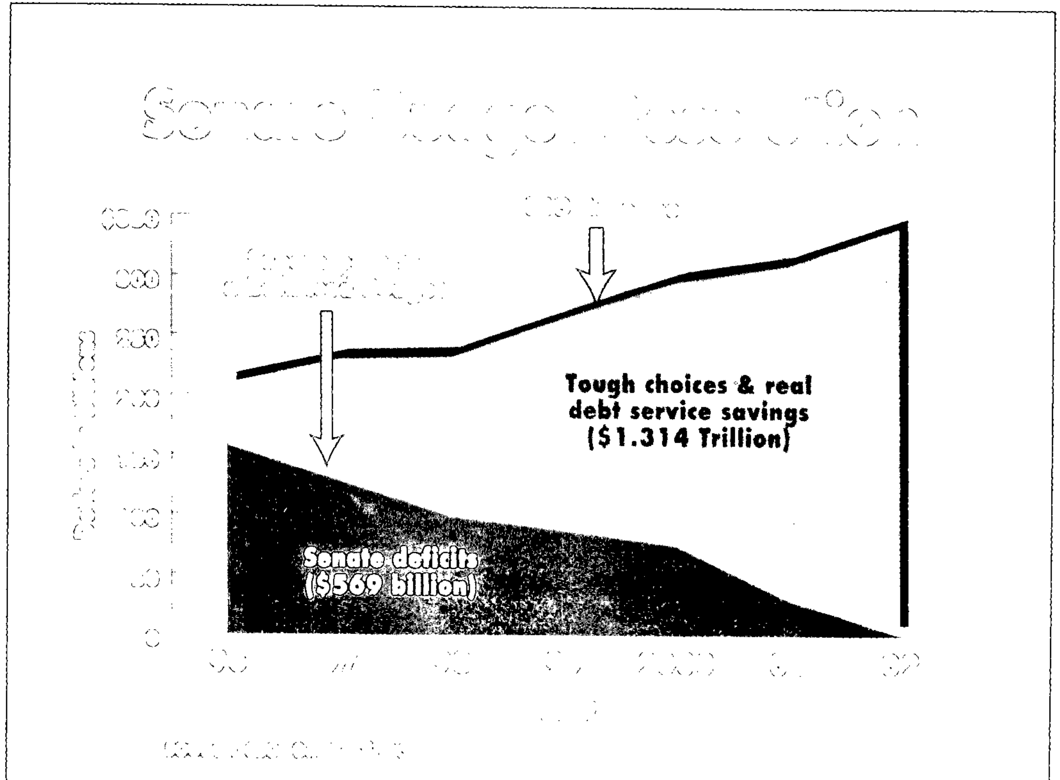
Differences in estimates of other mandatory programs contribute $23 billion to the difference between CBO's and OMB's estimates of the baseline deficit. Finally, a $30 billion difference in projected net interest costs primarily reflects the debt service on the increase in the projected deficits that stems from CBO's other reestimates.

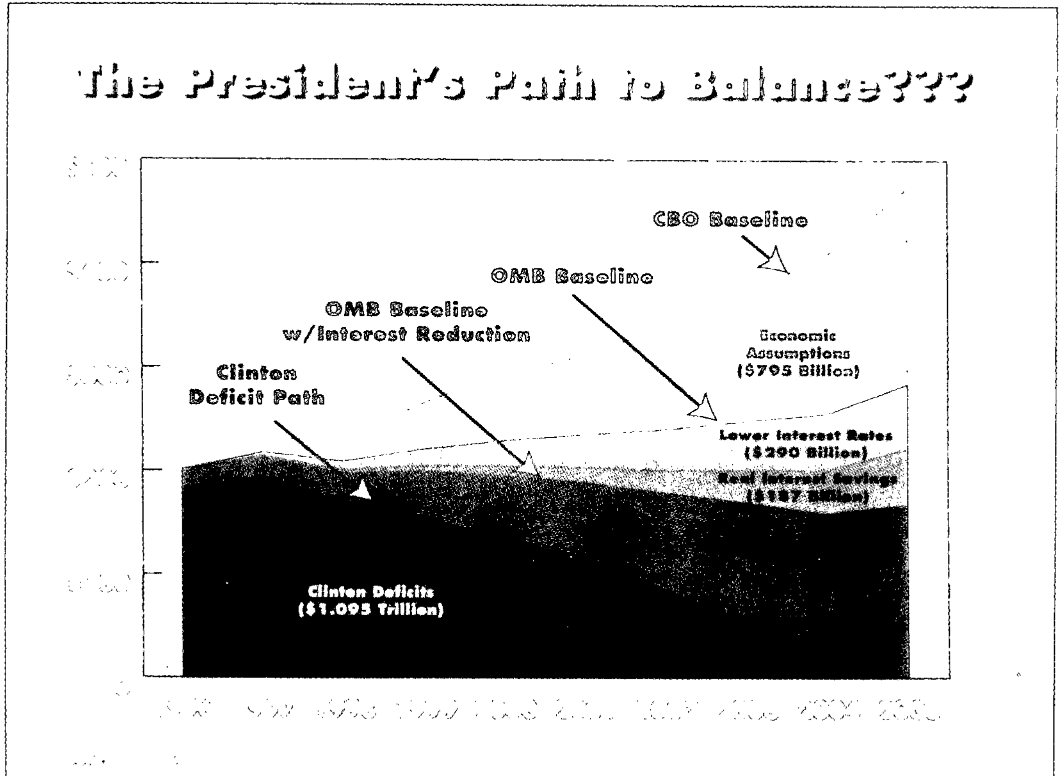
CONCLUSION

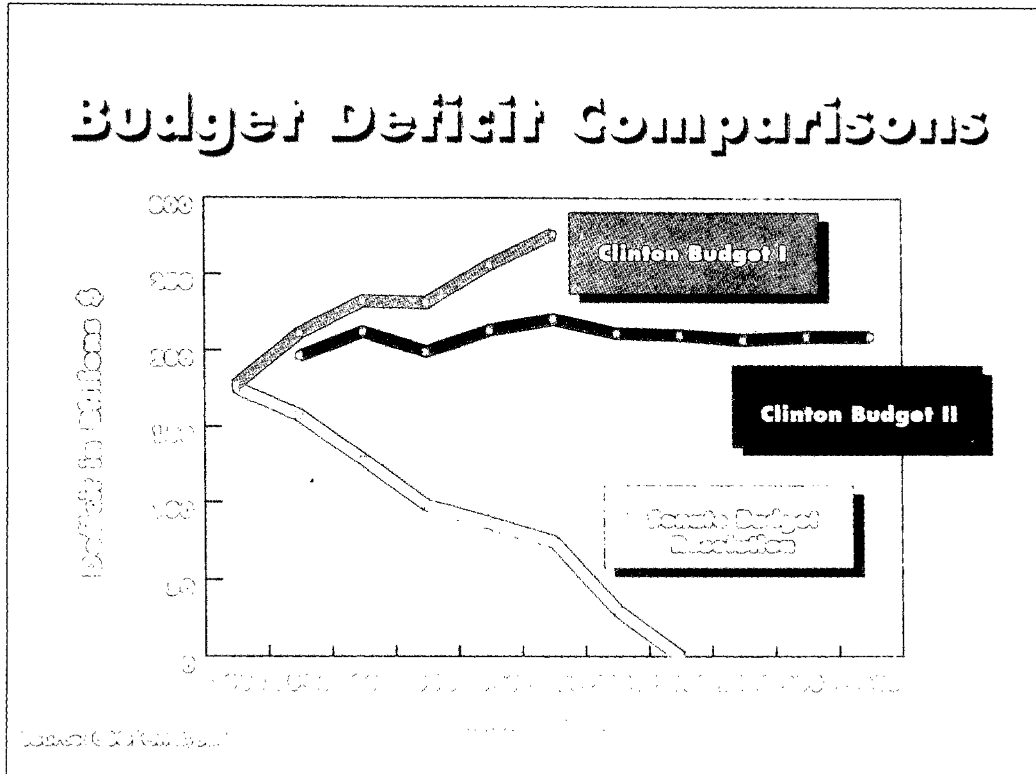
The Congressional Budget Office has long stressed the importance of bringing the federal deficit under control. Large federal deficits crowd out capital investment, raise interest rates, and restrict economic growth. If noninterest spending exceeds tax revenues, growing federal deficits will eventually lead to rapidly rising federal interest costs, unsustainable increases in the federal debt, and a reversal in the long-term trend of rising living standards.

The Administration's new budget proposal represents a significant step toward limiting the rise in federal deficits and debt. CBO estimates that if the plan's targets were met, the budget deficit would remain roughly constant in nominal terms and would decline in relation to the size of the economy. Although the plan would not produce a balanced budget, if carried out it would start to move federal fiscal policy off its present, unsustainable course.

The uncertainties involved in budget projections are legion, and small differences in estimating assumptions can lead to large differences in the projected deficit five or ten years in the future. Although the Administration's budget projections are somewhat more optimistic than those of CBO, they fall within the range of plausible outcomes. The 20-year history of Congressional budget projections, however, suggests that the budget deficit is much more likely to exceed projections than to come in lower. It is CBO's view that erring on the side of caution increases the likelihood that a balanced budget will actually be achieved in the time desired.


Tough choices & real debt service savings ($1.314 Trillion)
Senate deficits ($569 billion)


The President's Path to Balance???
CBO Baseline
OMB Baseline
OMB Baseline w/Interest Reduction
Clinton Deficit Path
Economic Assumptions ($795 Billion)
Lower Interest Rates ($290 Billion)
Real Interest Savings ($187 Billion)
Clinton Deficits ($1.095 Trillion)


Budget Deficit Comparisons
Clinton Budget I
Clinton Budget II

PREPARED STATEMENT OF ROBERT D. REISCHAUER

Mr. Chairman and members of the Committee, I appreciate this opportunity to discuss with you the effort that is now underway to balance the federal budget. The President's speech on June 13 was a significant and constructive contribution to this effort. The President and the leadership in the Congress now have reached agreement on what the nation's basic fiscal policy objective should be---namely, to balance the federal budget by a set date in the not-too-distant future. Notwithstanding this consensus about the objective, significant differences remain between the President and the leadership in the Congress concerning the magnitude of the underlying problem, the amount of time that should be taken to resolve it, and the specific measures that should be pursued to achieve budgetary balance. While the rest of my statement elaborates on these differences, the primary message that I would like to convey to you is that these disagreements should not be allowed to derail this historic opportunity to enact legislation that substantially reduces the deficit.

How Big is the Problem?

The major difference between the President's and the Congress' budget balancing plans is the size of the deficit that each is attempting to eliminate. The Congress' view of the problem is based on the Congressional Budget Office's (CBO's) baseline budget projections. These projections, which assume no changes in policy and adherence to the discretionary spending caps through fiscal year 1998, show the deficit growing steadily and rapidly over the next ten years. CBO projects that the deficit will rise from $175 billion in fiscal year 1995 to $349 billion in 2002 and to $472 billion in 2005 (See Chart 1). As a fraction of GDP, CBO sees the deficit rising from 2.5 percent in 1995 to 3.5 percent in 2002 and to 4.1 percent in 2005. The rapid rise in the baseline deficit means that the task of balancing the budget does not become any easier if it is stretched out over a longer period of time.

The President's budget balancing plan is based on the Office of Management and Budget's (OMB's) projections of the baseline deficit. Like those of CBO, OMB's projections assume no policy changes and adherence to the discretionary spending caps through fiscal year 1998. While OMB projects the baseline deficit to rise after 1995, the increases are quite modest, from $193 billion in fiscal year 1995 to $240 billion in 2002 and to $266 billion in 2005 (See Chart 1). Compared to OMB's estimates of GDP, the baseline deficit is projected to shrink modestly over the next decade, from 2.7 percent in 1995 to 2.3 percent in 2002 and to 2.2 percent in 2005. Because OMB's projected baseline deficits do not grow in real terms and shrink relative to the size of the economy, the task of balancing the budget becomes easier the longer the period of time taken to eliminate the deficit.

The differences between CBO's and OMB's baseline deficit estimates, which amount to some $206 billion by 2005 (See Chart 2), are the result of different economic and program or technical assumptions. OMB expects nominal GDP to grow, on average, at a slightly faster rate over the next decade than does CBO. As a result, its estimate of nominal GDP in 2005 is about three and one-quarter percent larger than that of CBO. The differences in nominal GDP reflect OMB's higher estimates of both real economic growth and the increase in the GDP deflator. Considering the inherent uncertainty in economic forecasting, these differences are quite small. For example, after 1996 OMB expects real GDP to grow each year only 0.1 or 0.2 percentage points faster than does CBO. As a result of its higher estimate of nominal economic growth and differences in other technical assumptions, OMB's projection of baseline revenues for 2005 is about $67 billion higher than that of CBO (See Chart 2).

OMB also assumes that the CPI will increase at a rate that is between 0.2 to 0.3 percentage points slower each year than the rate assumed by CBO. Slower CPI growth translates into lower baseline costs for indexed benefit programs. Consistent with its view of economic growth, OMB also assumes a slightly lower unemployment rate than does CBO. This difference translates into somewhat lower spending on unemployment compensation and other entitlement programs that are sensitive to the level of joblessness. Altogether, OMB projects spending on the non-medical mandatory programs to be about $33 billion less than does CBO in 2005.

Because both CBO and OMB use the CPI to inflate discretionary spending after the caps expire in fiscal year 1998, CBO's assumption that the CPI will grow at a faster rate contributes to its $20 billion higher estimate of baseline discretionary spending in 2005.

Not all of the differences between OMB's and CBO's economic assumptions lower the Administration's baseline deficit path relative to that of CBO. The Administration's long and short-term interest rate assumptions are generally a few tenths of a percentage point higher than those of CBO. Nevertheless, OMB's estimates of baseline net interest costs fall below those of CBO by 2002 because its lower baseline deficit path results in less debt. By 2005, the difference between CBO's and OMB's baseline net interest estimates is some $34 billion.

The most notable program differences between OMB's and CBO's baseline projections are in Medicare and Medicaid. While CBO anticipates that Medicare spending, net of Part B premiums, will grow at an average rate of 10.3 percent over the next decade, the Health Care Financing Administration's (HCFA) estimates, which OMB incorporates into its baseline projections, anticipate an average growth rate of 9.8 percent per year. The differences with respect to Medicaid are a bit larger; CBO anticipates an average growth rate of 10.0 percent while HCFA expects Medicaid spending to rise by 9.2 percent a year. Over the course of a decade, these modest differences compound so that by 2005 OMB's baseline estimate of Medicare spending is some $32 billion below that of CBO and its estimate of Medicaid outlays is $20 billion below CBO's.

The large gap between CBO's estimate of the baseline deficit that must be eliminated to balance the budget and OMB's estimate of the problem raises the question, "Which estimate is likely to be more accurate?" The simple answer to that question is that no one knows. The methodologies used to generate the long-run baseline budget projections are necessarily crude. The uncertainty that surrounds the likely course of the economy five to ten years from now is great. Furthermore, if the past is any guide, unexpected surges and slowdowns in entitlement program spending are likely to occur in the future.

Some critics have suggested that the Administration has relied on excessively optimistic economic assumptions for its baseline budget projections---that Rosy Scenario's younger sister is making her debut. This charge is unwarranted. OMB's economic assumptions for the 1995 to 2000 period are not significantly different from those of the Blue Chip Consensus and are less optimistic than those of a number of private forecasters. Compared to the projections made by the few forecasters who have the nerve to predict the course of the economy past 2000, the Administration's assumptions shade toward the optimistic, but are well within the bounds of the possible.

When compared to the differences that existed through much of the 1980s, the differences between OMB's and CBO's views of the economy are quite modest. For example, between 1982 and 1991 the average percentage gap between OMB's and CBO's forecasts for real

GDP after five years was 5.6 percent, over four times larger than the difference that exists between the two agencies' current real growth projections after a decade.

A recent revision by CBO has reduced one of the differences between CBO's and OMB's baseline economic assumptions. In estimates made for the budget committees, CBO has incorporated a 0.2 reduction in its estimate of the increase in the CPI after 1998 to reflect the likely effect of re-benchmarking the CPI to the consumption patterns of the 1993-1995 period. CBO has estimated that this change reduces the $206 billion gap between the two agencies' deficit estimates for 2005 by $18 billion.

While OMB's economic assumptions should not be viewed as a flight of unbridled optimism, neither should CBO's assumptions be viewed as excessively pessimistic. CBO's stable interest rate assumptions may be too benign. With the baseline federal deficit rising as a percent of GDP, it might be more reasonable to expect that the increased pressure on credit markets would push rates up a bit. Furthermore, while the CBO projections could accommodate a mild recession at some point during the next decade, a more realistic assumption might be to anticipate two mild recessions or one more severe downturn.

The program assumptions are inherently even more uncertain than the economic assumptions. The future course of entitlement spending, which has been the wild card in recent years, will depend not only on demographic developments and the strength of the economy, but also on the political climates in the states, court rulings, and changes in the private health care market. CBO's assumptions about the growth of Medicaid and AFDC implicitly assume that states will be able to find substantial resources for their matching shares. If states find themselves under severe budgetary pressure, state matching funds may not be forthcoming and, as a consequence, federal costs may not grow as rapidly as CBO expects. The same result would occur if the political climate in the states demands further retrenchment of welfare programs. Alternatively, the innovations some states are making under the Section 1115 waivers to broaden Medicaid coverage and place beneficiaries in managed care systems may prove to be very popular with the voters. If that is the case, states may decide to expand Medicaid coverage to the limit and CBO's projections of federal costs could prove to be too low.

Baseline Medicare spending will be affected by developments in private health care markets which are notoriously difficult to predict. The managed care revolution that is sweeping through employer-sponsored insurance markets could lead to an excess of providers which might put downward pressure on prices. This could result in lower update factors for Medicare hospital and physician payments than is now anticipated in the baseline projections. Alternatively, providers struggling to maintain their incomes in a world that is increasingly dominated by capitated payment arrangements, may turn to Medicare patients to supplement their incomes. While Medicare's volume performance standards and utilization reviews will limit their ability to increase utilization, some increased volume pressure would not be surprising. DRG code creep could also become a more serious problem than either CBO or HCFA anticipates. Whether OMB's 9.8 percent average Medicare growth rate or CBO's 10.3 percent rate proves to be more accurate will also depend on the course of technology---on the diagnostic tools, surgical procedures, treatments, and pharmaceuticals that will be developed over the next ten years and on the costs of these innovations. We can only speculate about such developments.

Considering the substantial uncertainty that surrounds the size of the deficits that will occur five to ten years from now if policies are left unchanged, which definition of the underlying problem should the Congress use as it formulates its budget plans? Prudence suggests that the Congress should stick with the CBO estimates of the size of the problem if it believes that it is important that the budget plan it adopts be viewed as one with a reasonable, but by no means certain, chance of eliminating the deficit by the target year. As has been true in the past, unexpected and unforeseeable developments will buffet federal spending and revenues. If history is any guide, these surprises will worsen, not improve, the deficit outlook more often than not. For this reason, starting from the more cautious set of projections represents the most prudent course. If CBO's estimate of the size of the problem proves to be too pessimistic, the retrenchment called for in the final years of the plan could easily be scaled back, tax cuts could be provided, or we could enjoy the first budget surplus since fiscal year 1969.

How Long Should the Budget Balancing Effort Take?

The second major difference between the President's plan to balance the budget and the approach embodied in the Congressional Budget Resolution is the length of time it takes to erase the deficit. The President would eliminate the deficit over a ten year period while the Budget Resolution's plan would get the job done in seven years. As I pointed out before, under the Administration's baseline deficit path, the task becomes easier if the period is stretched out; under the CBO deficit path, that is not the case.

Three factors should be considered when deciding how long to take to balance the budget. The first is the risk that the fiscal restraint associated with the effort poses for continued growth of the economy. The second is the possibility that sharp spending cutbacks could impose undesirable hardship on vulnerable groups and institutions. The third is that the effort might lose credibility if it is dragged out over too long a period of time.

Unavoidably, the spending cuts associated with both the President's plan to balance the budget and the Budget Resolution's plan will impose some fiscal restraint on the economy. But the magnitude of this restraint is quite modest. The change in the primary deficit as a percent of potential GDP---an accepted measure of fiscal restraint---does not reach 0.6 percent in any year under the various plans. In most years, this measure is below 0.3 percent. Whatever contractionary effects this modest dose of restraint might have, much if not all of it could be offset by easier monetary policy. The retrenchment should cause interest rates to fall somewhat which will stimulate private investment and purchases of consumer durables. Net exports should strengthen with a weaker dollar. In addition, the Federal Reserve could take actions to lower rates further. In short, whether the deficit is eliminated in seven or ten years, the risk of the effort derailing the economy is likely to be relatively small.

If there is genuine concern about the cyclical consequences of the deficit reduction effort, it would make more sense to spread the restraint more evenly throughout the plan period than to lengthen the period of time used to achieve balance. Both the Budget Resolution plans and the President's plan load the fiscal restraint into the first year and the last few years. Given the present uncertain state of the economy and the fact that it is already too late for easier monetary policy to do much to offset the effects of any cutback in fiscal year 1996 spending, it may be prudent to shift some of the fiscal year 1996 restraint called for in the Congressional and Presidential plans into the 1997 to 2000 period. Similarly, it would make sense to move a portion of the cuts that have been loaded into the final years of the plans into the middle years.

Even though the planned spending cutbacks may pose only a slight risk to the economy, they could impose significant hardship on those individuals who have little ability adjust when the transfer payments or services they receive from federal programs are reduced or the orders their businesses receive from the government are suddenly curtailed. Undesirable program disruptions could also result if state and local governments and non-profit entities are suddenly faced with new responsibilities that require administrative and institutional cap-abilities that they have not yet had an opportunity to develop. The more program changes called for by a deficit reduction plan, the more sense it makes to spread the adjustment out over a longer time period in order to facilitate a more orderly and sensible transition.

Judged on this dimension alone, the President's plan probably requires the shortest implementation period because its budget cuts and program adjustments are significantly smaller than those of the Congressional plans. The spending cuts and program adjustments called for by the House version of the Budget Resolution, in contrast, are the most far reaching. They not only eliminate a larger estimate of the deficit, but also provide for a substantial tax cut. In addition, they would place significant new responsibilities on the states because Medicaid and several welfare programs are transformed from open-ended federal matching grant programs into block grants. On this score, it would make sense to phase in the House plan over a longer period of time than the President's plan. Whether that period is seven, eight or ten years long is open to debate.

The credibility of the plan is the third factor that should be considered when deciding on the length of time over which to balance the budget. In recent years, deficit reduction delayed often has been deficit reduction avoided. When a deficit reduction plan stretches over many years, policy makers will be tempted to backload the sacrifice into the plan's final years. Claimants will always hope that circumstances will change and the retrenchment will be canceled before the day of reckoning. For this reason, a credible deficit reduction plan can not be stretched out over too long a time period. Whether seven or ten years constitutes the boundary of a reasonable time period for a deficit reduction package is debatable. But it is worth noting that a decade is longer than a single individual can remain in the White House. Furthermore, during recent ten year periods we have seen world conditions change dramatically, the attitude of the public toward government swing 180 degrees, and the economy shift course in significant ways. All of this argues for the shorter time span.

How Should the Budget be Balanced?

While the major difference between the President's plan and the plan being developed as part of the Fiscal Year 1996 Budget Resolution is the amount of deficit reduction each would impose, they also differ with respect to how a balanced budget would be achieved. Because the plans reach balance in different years and because the baselines are different, any comparison of the approaches necessarily involves some distortion---some comparisons of apples with oranges.

Looking at the target year for each plan---that is, 2002 for the Congressional plans and 2005 for the President's plan---the policy-related spending cuts amount to about $302 billion in the House-passed version of the Budget Resolution, $272 billion in the Senate-passed version of the resolution, and $188 billion in the President's plan. Of the total cuts in the target year, the President's plan looks to discretionary spending and Medicare to bear relatively more of the burden than is the case with the Congressional plans (See Chart 3).

In spite of these differences, the composition of future federal program spending would not be affected in a major way if one of the approaches to balance the budget were adopted over another. For example, the three plans anticipate non-defense discretionary spending amounting to between 15.5 percent and 15.8 percent of all non-interest spending (See Chart 4). While the President's approach expects a smaller portion of program spending to be devoted to defense and more to Medicare and Medicaid than do the Congressional plans, these differences are quite modest when compared to the compositional shifts that have taken place over past five to ten year periods.

Conclusion

As was the case in 1990 and 1993, policy makers have an opportunity this year to address the major problem facing the nation. This opportunity should not be sacrificed on the altar of short-run political advantage. Nor should it be squandered because the President and the Congress disagree over the size of the problem or the length of time needed to resolve it. A balanced budget may be symbolically important, but from an economic standpoint reaching a $50 billion deficit would represent a tremendous accomplishment. It is certainly better to enact measures that would cut the deficit in half over the next seven years than to come up empty handed.

Even if the Congress approves measures that are projected, using current assumptions, to lead to a balanced budget at some future date, we all know that economic shocks, changing priorities, and unforeseen demographic and technical developments will soon render these estimates invalid. Many mid course corrections will be required. Keeping the nation on an appropriate fiscal policy path is a never-ending task.

Thank you.

Chart 1

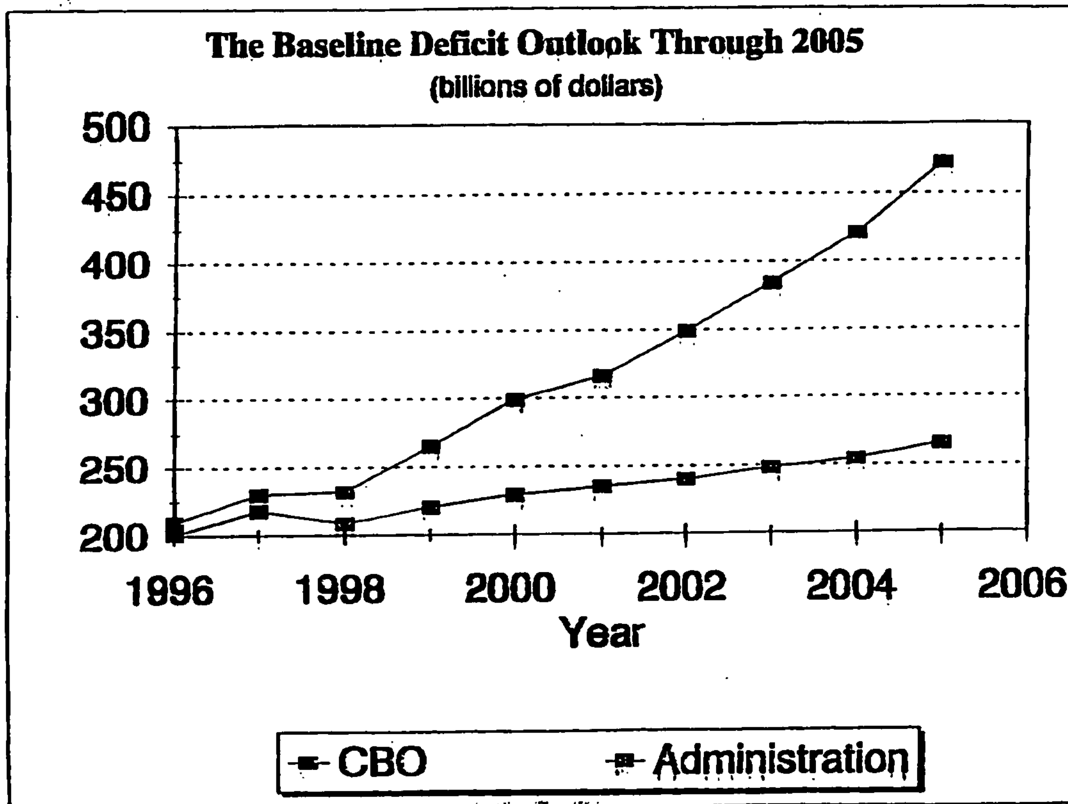
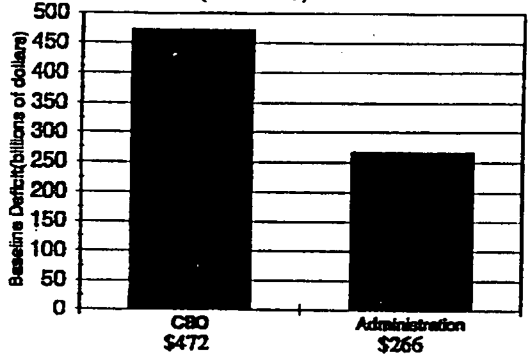

The Baseline Deficit Outlook Through 2005
(billions of dollars)
500
450
400
350
300
250
200
1996
1998
2000
2002
2004
2006
Year
CBO
Administration

Chart 2

Difference Between CBO and Administration Baseline Deficits for 2005
(billions of dollars)



Breakdown of the Difference Between CBO and the Administration Baseline Deficits for 2005
(billions of dollars)

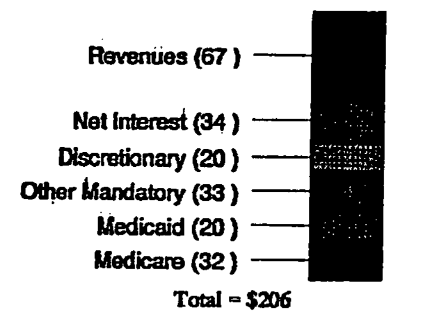


Chart 3

Compositon of Policy-Related Spending Cuts
in Budget Balancing Plans' Target Year
(billions of dollars)

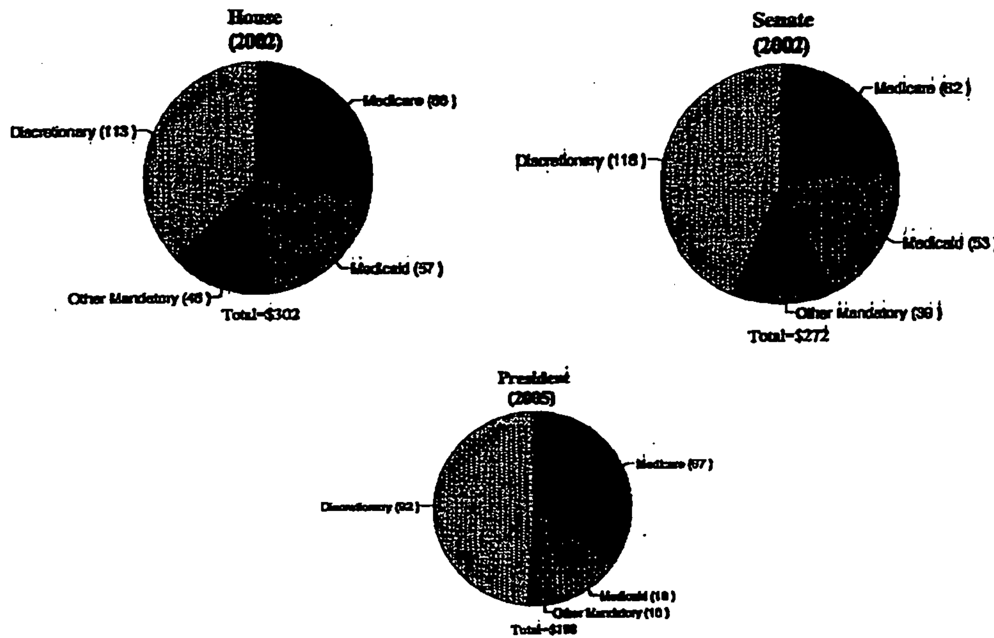


Chart 4

Composition of Non-Interest Outlays in Budget Balancing Plans' Target Year