

AFTER THE HURRICANES: IMPACT ON THE FISCAL YEAR 2007 BUDGET

HEARING BEFORE THE COMMITTEE ON THE BUDGET HOUSE OF REPRESENTATIVES ONE HUNDRED NINTH CONGRESS FIRST SESSION

HEARING HELD IN WASHINGTON, DC, OCTOBER 6, 2005

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THURSDAY, OCTOBER 6, 2005

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

The committee met, pursuant to call, at 2:10 p.m. in room 210, Cannon House Office Building, Hon. Jim Nussle (chairman of the committee), presiding.

Members present: Representatives Nussle, Ryun, Crenshaw, Putnam, Wicker, Garrett, Barrett, Diaz-Balart, Hensarling, Ryan, Simpson, Bradley, Mack, Conaway, Chocola, Spratt, Moore, DeLauro, Capps, Cooper, Davis, Jefferson, Allen, Case, and Cuellar.

Chairman NUSSLE. I call the Budget Committee to order.

Before we begin with the official agenda, let me pause for a moment; and, Doug, I know this is particularly important for you, your team, and family down at the CBO (Congressional Budget Office).

The committee was very saddened to hear the news this week of the death of Bob Sempsey from a long-term illness. We offer Bob's family and all of the CBO staff our sincerest condolences.

For those who didn't know Bob very well, I can say that he was well-known to many of us. He worked for the CBO for nearly 25 years; and with his colleagues down at what is called the scorekeeping unit, they provided this committee and the Appropriations Committee with the vital cost estimates and scorekeeping tallies of the annual appropriation bills that are the core of the budget and appropriations process.

He was also well-known in the extended family of the budget community and was famous for having a very dry sense of humor and for being an avid car enthusiast and certainly for his devotion to his family, Emily, Zack, and R.J.

What is not commonly known about Bob is that he worked for the Ringling Brothers Circus before joining CBO, which was probably good training for the budget and the process.

I am sure all of us will miss Bob, particularly down at CBO. So we offer just a moment of pause just to express our condolences and to let his family know that his service to his country, to this committee, and to Congress was deeply appreciated and his service will be deeply missed.

Mr. Spratt.

Mr. SPRATT. Mr. Chairman, thank you for allowing me to add a word of sympathy to your staff and to the family of Bob Sempsey.

We knew him better by his work product than by his personality, though his personality was well-known around here, and that work product was always excellent, and it is a symbol still of the legacy that he leaves in 25 years of service to CBO, the country, and the Congress of the United States. He will be missed here on Capitol Hill as well as at CBO.

Thank you, Mr. Chairman.

Chairman NUSSLE. Thank you, Mr. Spratt.

Good afternoon and welcome to the Budget Committee hearing. When the committee last met back in July, our discussion at that time was what was called the midyear budget, an economic outlook; and things were looking pretty good at that point in time. We were continuing to see steady, strong economic growth and job creation. Tax revenues were up 15 percent over last year, we were keeping discretionary spending on track, and we were seeing a dramatic reduction in the deficit, in fact, a \$94 billion reduction in the deficit at that point in time.

Things certainly were not perfect, they never are, but we certainly seemed to be heading in the right direction. A couple of weeks ago Hurricane Katrina hit, and our Nation was devastated, and so many people and families were devastated.

It was the worst natural disaster on record, certainly everything has changed, and many things will change for quite some time. Within days, this Congress acted to get victims the critical emergency assistance they needed by approving \$62 billion in emergency funding; and Congress clearly remains committed to doing whatever is needed to recover from the disaster.

But, at the same time, we better understand that our obligation to the hurricane victims and to all Americans doesn't end with quickly writing a bunch of big checks, that is the easy part for Congress. Congress must now prove we can handle the heavier lifting that follows by making reasonable and responsible choices and priorities in the next phase of the Katrina response.

I think the first thing we need to do—and what is currently lacking, in my judgment—is to make a clear distinction between what is and what is not an emergency. I know that in the rush to get victims critical need and help in the first days and weeks after the storm, making this distinction was certainly far from our top priority, and appropriately so, but, today, a month later, it is time.

Congress must set clear criteria to ensure that any spending deemed an emergency, and thus not subject to budget limits, is actually used to respond to the immediate and urgent needs of the people and families in the gulf. If funding requests do not meet these emergency and reconstruction criteria, then I believe, what is not the emergency portion of the response must be subject to the judgment, the deliberation, and oversight that are part and parcel of the regular budget process for the U.S. Congress.

The purpose is not to limit help the Federal Government provides to hurricane victims, it is to prevent nonemergency spending from sliding through on what is often the fast track, without the proper oversight in the name of emergency relief.

Further, we must aggressively follow all of the funds to prevent waste, fraud, and abuse, ensuring that every taxpayer's dollar we spend is hitting its intended target appropriately and providing the

help that families need. This goes hand in hand with our government program reform efforts, which I would like to touch on here in a moment.

Congress must also begin to make a down payment on this emergency spending, I know there have been a myriad of ideas floated around. One that was most interesting to me—actually, I received two letters on this topic—were from my friends on the other side of the aisle. In them, they suggested that the best way to respond to this emergency was actually to cancel our plans to reform government programs. In simpler terms, Congress' best response to this immense new spending need spurred by the hurricanes is to refuse to even look for savings in other areas of the budget and instead just increase taxes.

Interesting logic, but I do not believe that is the right policy at this time for our country. From several folks on my side of the aisle, the Republican Study Committee (RSC), as an example, which I will note is particularly well represented on this committee, we have heard suggestions about off-setting Katrina costs, ranging from focused program cuts to across-the-board spending rescissions.

Just this past Tuesday, President Bush said in a press conference that Congress should, "pay for as much of the hurricane relief as possible by cutting spending."

The President also pledged to work with Congress to finance Katrina reconstruction efforts in a fiscally responsible way and supported increased savings and commitment in mandatory programs; and my response to that is, great. But to get this done we need to have a strong partnership among the House, the Senate, and the administration. So here is what I believe Congress must do.

First, Congress must reduce spending and make a down payment toward the emergency spending itself. In consultation with the leadership, I will propose an amendment to the budget for fiscal year 2006 calling for such additional spending in both mandatory and discretionary. I note that prior to Katrina, we were on a course to holding the nonsecurity, discretionary spending below last year's level.

I would suggest that we further reduce this spending in three ways: first, with additional across-the-board discretionary reductions; second, a rescission package for unnecessary or low priority 2006 funds; and third, by permanently eliminating and deauthorizing programs that have been zeroed out by the appropriators so that they don't grow again and become priorities in the future.

Appropriations Chairman Jerry Lewis has done a remarkable job this year, and I have every confidence that he and his committee can make this additional step.

On the mandatory side or the automatic spending side of the budget, I propose that total net savings for reconciliation should be increased from the current \$35 billion amount that was in our budget resolution, to a minimum of \$50 billion in savings over the next 5 years.

In addition, I propose that any hurricane-related mandatory spending increases must be fully offset within that amount, mean-

ing this is a \$50 billion net savings from government reform. Long after the current budget challenge, our challenges with mandatory spending will continue to exist. The baby boomers will still retire, medical costs will continue to skyrocket, and our largest government programs will still grow far beyond our means to sustain them.

We must not fail to get ahold of this spending or simply throw up our hands and say that it is too hard or that now is not the right time or it is too difficult or that plan does not work, or I do not have a plan. An alternative, as certainly many will continue to suggest, this spending, which currently takes up over a half of the Federal budget and is quickly growing, will eventually crowd out every other priority: education, agriculture, science, the environment, you name it. It will severely limit our ability to cover our basic costs, let alone respond to any further disaster.

And this isn't just about saving money, it is about reforming our largest, most critical government programs, many of which haven't been updated since their creation. Let me say that again. Many of these programs that we are talking about have not been updated, reformed, revised, or modernized, since their creation. Or been updated to ensure they are meeting their fundamental responsibilities and providing assistance to those who are most in need. So we better get started, and we better do it now.

Again, this year's budget required \$35 billion in savings. We can do that and more without losing sight of the needs related to the hurricane victims.

Second, this committee will begin work on a fiscal year 2007 budget now. We will not just add on emergency spending or give a blank check for an undefined notion of reconstruction. We must prioritize next year's budget to reflect this enormous Nation-changing event.

We must begin now to debate the appropriate role for the Federal Government in any reconstruct effort. We must ensure that any nonemergency costs, including reconstruction, be addressed through the regular budget process. That means the administration should provide details for any reconstruction plan, a full accounting of the reconstruction costs; and the President's budget must include a post-emergency reconstruction financing plan. We cannot fund hurricane reconstruction through these regular, predictable emergency requests to Congress.

I haven't been shy about my frustration with the administration's financing of the war in Iraq through repeated supplementals without details. I have adjusted my budgets to reflect forward-planning of the war's costs, but more needs to be done. Congress has already provided an unprecedented \$62 billion in disaster relief, largely without an up-front explanation of how that money would be spent or how it would be financed. That may have been appropriate, but I understand that about two-thirds of that emergency funding remains in the Federal Emergency Management Agency (FEMA) accounts today, two-thirds of that \$62 billion.

That said, I understand that \$62 billion may not be the final number, so I want to start planning now for any requests. And the best way to do that I believe is through the regular budget process.

Also, starting this year, I will again insist that future budgets must include more realistic funding for natural disasters—they are bound to occur, and we are bound to cover them—to avoid a perpetual cycle of emergency spending. I have attempted these mechanisms in the past, and I believe the time for a rainy day account has finally arrived in Congress.

So here is the bottom line. Congress needs to clearly identify the emergency spending from the disasters in the gulf. We need to make a down payment on this emergency spending by reducing spending and reforming government over and above what is already planned for in this year's budget.

In addition, I challenge the administration that any plan for reconstruction be detailed in its policy to answer three important questions: What is the total cost? How will it be spent? And how will it be financed?

Finally, it is my intention that today's hearing marks the beginning of Congress's deliberations on the fiscal 2007 budget, which I intend to accelerate from its traditional schedule.

On a final note, I have heard loud and clear, and I am sure you have, too, from your constituents, that while they want to do everything reasonable to help the people in the gulf they want us to do it responsibly. For me, it was probably best summed up by a gentleman that I met in Des Moines who experienced the flood of 1993, that was up until this disaster one of the largest natural disasters in history. He asked me a question, and this is as a victim himself. He said, explain to me why it is compassionate—think about this. Why is it compassionate to rebuild a person's home 15 feet below sea level after this experience? Explain to me why that is compassionate? And explain to me why it is reasonable to do it with my tax dollars. He wants a plan, and he wants it to be in the context of a fiscal blueprint.

It is a question that we must be able to answer, certainly, to meet the needs of the people in the gulf—we all know that—but to meet the needs of the taxpayers who finance it as well. We have asked Doug Holtz-Eakin, the Director of CBO, to be with us today to share his insight and perspective on these issues. We appreciate your return, Director Holtz-Eakin, and are certainly looking forward to your testimony.

I would now turn to Mr. Spratt for any opening statement he may have.

Mr. SPRATT. Mr. Chairman, thank you for calling this hearing; and, Director Holtz-Eakin, welcome back. Your testimony before our committee is always useful and illuminating, and I am sure that it will be today as it always has been.

This hearing comes at a very critical juncture. You have just heard the chairman's proposal, which is a bold proposal. Fiscal year 2005 has just ended. Yet most of the appropriations bills for 2006 have not been enacted, and the administration's budget for 2007 will soon be upon us, at the doorstep.

Clearly, Mr. Director, we need the best analysis you can furnish us of what the cost of Katrina has been to date and of what the likely cost is to be overall. That is particularly needed if we are going try to accommodate the cost and spread the payment for it, the financing for it, over a brief period of time.

Katrina descended on the gulf coast at a time when the Government's budgetary position was vulnerable, to say the least. In January of 2001, 4 short years ago, CBO and the Office of Management and Budget (OMB) both looked out 10 years and saw surpluses of \$5.6 trillion, cumulatively. We on our side looked warily at those surpluses, noting that nearly 75 percent of the cumulative amounts fell in the outyears. We took to heart your warning about the volatility of budget estimates. We were proud, frankly, of having moved the budget from a deficit of \$290 billion in fiscal 1992 to a surplus of \$236 billion in the Clinton years, and we did not want to risk our hard-won gains, so we warned against betting the budget on a blue sky forecast.

Neither our advice nor our budgets were adopted. Instead, we have had five budgets proposed by the administration and approved by Congress, and we have, as a result, large and chronic deficits. So we must supply relief for Hurricane Katrina and Hurricane Rita from a position of fiscal weakness, and that is one reason the chairman has made the statement he just made.

But, in truth, the budget was in big trouble before Katrina, before Hurricane Rita. The deficit for 2005 was expected to be the third largest in history. The cost of Katrina adds to the deficit, but just before Katrina, CBO informed us in a letter that I submitted to CBO that we faced \$4 trillion in deficits if we implemented the administration's policies—tax and spending policies—over the next 10 years, \$4 trillion in additional deficits.

Congress, though, now is grappling with what the Government can do to help people recover from Katrina and Rita and how the cost of those actions, those recovery actions, relief actions should be financed. We have responded by enacting measures that have cost \$70.8 billion thus far, and we know that additional sums, additional requests from the administration are on the way.

I have to note with the some irony the inconsistency in how the Congress is mounting its effort now to approach hurricane relief versus other emergency costs. Congress has approved—and I will hasten to add I have supported—various supplementals to fund operations in Iraq, which have not been offset, none of it. Congress has approved various tax cuts, despite their contribution to the bottom line, to the deficit, which have not been offset.

So the question arises, why offset the rebuilding of Biloxi but not the rebuilding of Baghdad? Has disaster relief been offset in the past? I would ask that to the Director, if he has any knowledge of that, to respond to that; and, if so, how should it be offset in all fairness, equitably in the wake of this particular disaster?

In discussing offsets for hurricane costs, my colleagues on the other side have targeted programs like Medicaid, student loans, and food stamps, and this begs another question. Are we going to spread the costs of this disaster equitably over our whole population and make our response a sacrifice that we all share, or are we going to load the cost on those least able to bear it?

In truth, the cuts being considered, for example, in Medicaid and student loans, were proposed long before Katrina and not to offset disaster costs but to partially offset \$70 billion in additional tax cuts. Those tax cuts are still called for in the budget we are operating upon, implementing still now, called for in the budget for

2006, along with \$36 billion more in tax cuts not reconciled but called for in the resolution. The resolution sanctions another \$106 billion in tax cuts.

So I think it is fair to ask, if our object is to diminish the impact on the deficit and pay for Katrina, are we going to adopt these spending cuts for that purpose or to further offset tax cuts? Or have the tax cuts been scrapped and will attendant spending cuts, 100 percent of them, be used to offset the cost of Rita and Katrina?

In the last several days, and just a few minutes ago, there have been various other proposals. The chairman has proposed basically a new budget resolution. So the question becomes, are we going to write tax reconciliation instructions as well as spending reconciliation instructions? Are we going to raise the spending reconciliation instructions from \$35 to \$50 billion and use those to further offset tax cuts of \$106 billion, or table, defer, scrap the tax cuts and fully try to implement the spending cuts in order to manage the cost of Katrina?

Since 2001 when the Bush administration first brought forth its trillion-dollar tax cuts, we have seen the stock market plummet and the economy slide into recession and then slowly recover. We have experienced the awful tragedy of 9/11 and our response to it. We have deployed thousands of troops to war in Afghanistan and for an even longer and larger war in Iraq, and we have now suffered the greatest natural disaster since the San Francisco earthquake.

The 10-year surplus of \$5.6 trillion has become a 10-year deficit of \$3.5 trillion. The premises on which the Bush tax cuts were predicated have changed and changed drastically, but the tax cuts keep coming, at least unless they are deferred until we have dealt with the cost of Katrina and Rita and other expenses, including, for that matter, the emergency costs of financing our deployments in Iraq and Afghanistan.

Today's testimony and CBO's ongoing work will be a great help to us as we grapple with these admittedly extremely difficult problems. Director Holtz-Eakin, thanks again for being here. We look forward to your testimony and your guidance as we enter upon this endeavor.

Thank you very much.

Chairman NUSSLE. I would ask unanimous consent that all members be allowed to place an opening statement in the record at this point.

Without objection so ordered.

[The information referred to follows:]

PREPARED STATEMENT OF HON. THOMAS H. ALLEN, A REPRESENTATIVE IN CONGRESS
FROM THE STATE OF MAINE

The costs of recovery, relief, and reconstruction after Hurricanes Katrina and Rita are great. Congress has already appropriated more than \$60 billion for Katrina, making it, by a factor of four, the most expensive natural disaster in American history and some estimates put the total cost at around \$200 billion.

Members of Congress have been debating "how to pay for Katrina." Senate Republicans have asked the President to propose spending offsets and suspend approved Federal spending. House Republicans have proposed specific cuts, including reducing or eliminating student loan and education programs, school lunch aid, Amtrak, health care for low-income families, public broadcasting, and habitat conservation.

As budget analyst Gene Sperling recently observed, it's the right topic, but the wrong question. He writes that "focusing national attention solely on finding the one-time savings to pay for the one-time cost of this horrible natural disaster risks distracting us from the far more damaging long-term fiscal deterioration caused by the administration's man-made economic policies."

Sperling notes that today's leaders fail to ask how to pay for the "dramatic, perpetual costs of permanent marginal, estate, dividend and capital gains tax cuts for America's most fortunate or the escalating tab for the President's prescription drug bill, not to mention the war in Iraq."

If leaders in Washington had been asking the "how do we pay for..." question in the last 5 years, perhaps they wouldn't have abetted our nation's slide from \$5.6 trillion in budget surpluses over 10 years that President Bush inherited, to the \$3.5 trillion in deficits over 10 years we face today; a swing of more than \$9 trillion dollars in the wrong direction.

When Congress considered the President's \$1.2 trillion tax cut in 2001, I warned that it was not affordable. But Republican did not ask "how to pay for" the largest tax cut in history, most of which benefited the wealthiest Americans. It passed, and prompted the dramatic descent from surplus to debt.

In the next 3 years, Congress approved three more large tax cuts. In none of these cases did Republicans ask "how to pay for" these drains on the Federal Treasury.

This past summer, Congress approved an energy bill with billions in subsidies for the oil and gas industry at a time when they were gouging consumers. Republicans never asked "how to pay for" this corporate welfare.

Then came Katrina. With so much devastation, dislocation and despair, with the need for Federal aid to rescue and rebuild so great, why have Republicans suddenly chosen this event to make a stand for fiscal discipline?

Many have noted that the estimate for Katrina recovery is equal to the cost to date of the war in Iraq (approximately \$200 billion). Why is it that Republicans demand spending offsets to help Americans rebuild from an unavoidable hurricane, yet are willing to spend taxpayer money freely to help Iraqis rebuild from an avoidable war?

The very week that the nation witnessed the drowning of New Orleans, the Senate was scheduled to vote on repealing the estate tax for the very few well-off couples with estates over \$7 million. This vote was postponed. If the bill is revived, fiscal sanity demands that Congress, the media and the public give as much attention to paying for the \$500 billion it will cost us during the next decade to eliminate inheritance taxes, as they have to Katrina's \$200 billion price tag.

I have long argued that the restoration of fiscal responsibility requires all sides to jettison hard-line ideology in order to reach bipartisan consensus. We need to put all options on the table, including spending cuts and upper-income taxes.

Trying to pay for Katrina without re-considering tax cuts is like trying to rebuild New Orleans without fixing the levees. It will just perpetuate the disaster.

A responsible and moral response to Katrina would be to put the people first, and adopt a package of incentives for job creation, retraining and housing choice that empowers Gulf residents to rebuild their communities. The challenge in Washington is whether leaders recognize that tough choices extend beyond the narrow question of "how to pay for Katrina." Will these big budget choices be consistent with our values of fairness and responsibility to future generations, and our commitment to promote a larger, more prosperous and more inclusive middle-class? Or will we continue the failed policies of recent years that put the enrichment of the few above the needs of the many? That is the real question posed by Katrina.

PREPARED STATEMENT OF HON. CONNIE MACK, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF FLORIDA

Mr. Chairman, I would like to begin by thanking you for putting together this important hearing today. I am proud to serve on this committee which, under your leadership, will be the first to take the lead and find significant savings in Federal spending in the aftermath of these two disastrous hurricanes.

Mr. Chairman, being from Florida, I have a sense of what the communities in the Gulf South are going through. In fact, several areas in my district are still picking up the pieces and trying to recover from the storms of last summer. To this day, there are still funds owed to several municipalities that the Federal Government promised to supplement. That is an unacceptable avenue to go down again for this event.

Beyond that, we all know how catastrophic hurricanes can be. But their damage is not merely limited to physical buildings and peoples' homes. They devastate the

infrastructure of communities, the economy of the area, and the psyche of the people.

As the citizens of the Gulf coast begin to get back on their feet, it is imperative that local and state governments lead and coordinate recovery efforts, with the aid of Washington and the private sector. This will undoubtedly be a long and difficult process, but the Gulf South will recover and thrive.

With that said, Congress is the steward of the people's money. It begins here in the Budget Committee and should be realized by all of our colleagues. We must be disciplined in how we spend and what we supplement for the recovery, and we must make sure we continue to appropriately fund the nation's priorities while taking real steps to reduce and eliminate wasteful spending.

Mr. Chairman, it is in that spirit that I welcome the opportunity to work with my colleagues to find a consensus on the role of Federal spending for this crisis. I trust we will be able to identify a responsible fiscal solution that fully funds all the integral, critical projects needed to help the Gulf region return to normal and, at the same time, keeps this government headed down the path of proper financial management and less government spending.

That, Mr. Chairman, is how we can best ensure the continued freedom, security and prosperity for all Americans and all of our citizens affected by these terrible storms.

I also, would like to thank Mr. Holtz-Eakin for taking the time to come before this Committee and give his insight on such important issues. Last week, President Bush, in an article from the Washington Post, floated the sweeping idea that all disaster response should be federalized, or at least a majority of it, and placed within the jurisdiction of the Department of Defense.

Though I understand his thinking, I fail to see the wisdom behind such a plan. Oftentimes, while this nation is in the midst of a crisis, the Federal Government tends to go beyond the constitutional lines of federalism in an attempt to make things right. In the end, these movements can be helpful, but usually it is at a detriment to state sovereignty or power.

I am fearful that if Congress were to enact this plan, it would place yet another strain on our nation's military forces, which are already performing so admirably under the current stresses.

Beyond issues of posse comitatus, if we were to place the burden of disaster relief on our armed forces, can you provide an idea of what level of additional funding would be required to equip them for such a mission? Would more resources be needed for this type of involvement? And finally, what levels would our troop forces have to be at in order to handle such a request?

Chairman NUSSLE. Director Holtz-Eakin, your entire statement will be made part of the record at this point as well; and you may proceed to summarize your testimony as you see fit. Welcome back to the committee.

STATEMENT OF DOUGLAS J. HOLTZ-EAKIN, DIRECTOR, CONGRESSIONAL BUDGET OFFICE

Mr. HOLTZ-EAKIN. Well, thank you, Mr. Chairman, Mr. Spratt, members of the committee, first and foremost for taking a moment to recognize the service of Bob Sempsey who left behind a legacy of quiet professionalism and indeed worked at the CBO up to days before his unfortunate passing. Recognition of that type means a great deal to his family and to the staff at CBO, and I thank you for it.

We are pleased to have the chance to be here today to be of assistance to the Budget Committee in this important area. Katrina and Rita are devastating and tragic events for the families in the areas affected, and they raise important questions about the scale of economic damages, about the overall path of the U.S. economy, about private sector and Government capacity for relief, recovery and restoration of economic activity, and about the ongoing role of such efforts in the budget and policy process; and it is entirely appropriate that this committee be the committee that addresses

these, as all of these issues will run directly through the U.S. budget.

We have submitted a fairly lengthy written statement for the record. We hope that the committee finds it to be valuable in its work. I will touch on three pieces of that written testimony in my remarks and then look forward to the questions that the committee might have.

The first is to simply recognize that these hurricanes, Katrina and Rita, are unequivocally bad for the U.S. economy. There is destruction of lives, destruction of personal property, homes, the capital of businesses and governments. But, nevertheless, they are not so damaging that we cannot anticipate that the overall economy will weather this particular setback and that recovery will likely take place within a year. However, in the aftermath of these events, overall economic risks are heightened and monitoring the path of the economy is far more important.

The second key thing I guess I would emphasize is that, going forward, the issue is economic growth, particularly in the affected regions and that the standard environment of incentives for private sector growth remains in place, that financial flows from the private sector in the form of insurance and loans and equity investments will be drawn to profitable activities. There are existing authorities for government financial flows to support the necessary public spending and infrastructure, and that economic growth does not have to be rethought in its broadest sense in this area, it needs to be allowed to continue.

And that, finally, Katrina and Rita are uniquely large in their scale and the dispersion, especially, of their impacts, but natural disasters are not unusual. Indeed, anticipating disasters can be part of the regular budget process, even more than it is now. Policies that support recognition in the budget not only can appropriately guide trade-offs for the Congress but also can move past paying in the aftermath to mitigating the overall scale of the economic damages and lowering their costs in the future.

So let me touch on each of those three and then take your questions.

We have now put out two interim updates of the impact of the hurricanes on the U.S. economy. I won't belabor the mechanics of those. We have some slides that we can show first which summarize some of the impacts that are in the written testimony and which reflect the letters we wrote, in particular to the chairmen of the House and Senate Budget Committees.

Hurricanes do several things. The first are there are direct losses. There are direct losses in the form of lives; there are direct losses in the form of capital. The total destruction of capital, to the best of our ability to guess it, is between \$70 billion and \$130 billion; in value of housing destroyed, something that looks like on the order of \$20 to \$30 billion, about a quarter of the losses; the destruction in the energy sector, something that is on the order of \$20 billion to \$30 billion, about 25 percent of the losses; for other private sector businesses, destroyed plant and equipment is another 20 to 25 percent of total losses; destruction of government capital, buildings, roads—all of the things that are the stuff of the public sector—is about 20 percent of the losses, on the order of \$13

to \$25 billion; and destroyed household goods, autos, and personal consumer durable goods are about 5 percent of total losses. So one of the things that happens is that there is a tremendous loss in wealth, and the economy is worse off as a result.

Economic activity is also impeded directly, and some of the impacts that one sees in this chart are losses directly in energy production and as a result of the loss of the housing stock. You lose the housing services, although they can be replaced somewhat if you can go live in another location. There is about a billion dollars, a little more than a billion dollars in estimated agricultural losses.

There are all sorts of things which impact directly in the region and lower national output. The national impacts derive from the impacts of these disruptions on two key national networks. The transportation network appears to be the lesser of the two impacts at this point.

Transportation has been restored to the Mississippi, although not all of the port facilities are yet fully operational by any means, the notable damage being in the Port of New Orleans; and there are damages to the highway networks and to the rail networks that apparently will not lead to national interruptions of any sort but will slow down deliveries and make them more costly to be sure.

Much of the attention has focused properly on energy impacts and the simultaneous loss of production facilities in the gulf. Hurricane Rita turned out to be more damaging in that regard it seems, with losses of refineries and pipelines and especially the power that runs them, and with the interruption of both production and the distribution of natural gas.

Those impacts spread more broadly in the economy, raising energy costs to consumers and business purchasers as well. The net effect of all of this appears to be something that knocks down the economy directly in the third quarter by a full percentage point to a percentage point and a half in terms of its overall economic growth.

Then some of the natural recovery mechanisms kick in. These are the rebuilding of houses, which boosts construction spending, and the purchase of business equipment to replace what is lost, which is the natural process of investment to rebuild the lost capital stock, and which will reduce, to some extent, the job losses. The guess is somewhere between 360,000 and 480,000 jobs were lost because of these events. The reconstruction and rebuilding activities will tend to produce some recovery there.

Under a set of assumptions—which have some risk—that roughly half of the insurance claims get paid out in the private sector to provide some financing; that the Government's about \$10 billion of relief and recovery financing flows in; that gasoline prices ultimately recover to being only about 10 percent higher than they were before Katrina struck, and that the rebuilding is not greatly delayed, that it is largely delayed only in the areas of great flooding, especially New Orleans, these other parts of the mechanisms might actually outweigh the negative impacts so we break even in the fourth quarter and actually start to grow faster than we might have otherwise expected early next year, getting the economy back to trend somewhere early in 2006. The message there is that this is an important event for the national economy but not an over-

whelming one and that policy, as a result, ought to be focused on the appropriate response in the regional areas, not for the Nation as a whole.

Are there risks here? Obviously. All of the risks are heightened. We have a much more fragile energy sector than we did prior to the hurricanes, consumers are less confident than they were prior to the hurricanes, and our scenario relies heavily on a relatively quick fall-off in these retail gasoline prices. That appears consistent with the pace of refinery recovery. It is important that this not turn out to be a very large crude oil event. That does not seem likely. The U.S. Gulf production is only about 2 percent of the world market.

The hurricanes will have substantial impacts in the natural gas market for a while to come, and those will feed into electricity prices. So there are impacts that will last a while, but it is our expectation that those negative impacts will be outweighed by the positive impacts of the rebuilding effort.

In that horse race between the negative impacts including the confidence of consumers and the rebuilding effects including the investment of businesses, it is important to remember that we do not have to decide the horse race now. Indeed, the Federal Reserve has the ability to monitor the evolution of the economy and adjust its policy accordingly. Everything that we have done assumes that they are on autopilot, and that is particularly unrealistic.

So that is the quick version of the economic impacts as we know them today, and I emphasize that all of this is subject to a lot more learning as we find out more about the damages themselves and the pace of the rebuilding in the area.

The second major point is that the recovery effort, the natural response of the economy to grow, to replace lost capital, to acquire more capital, and to generate jobs, does not require a major reexamination of Federal policy toward national economic growth or even regional economic growth. This is unique in its scale. It is unique in the dispersion of the evacuees.

But investing in new capital, raising the standard of living and creating jobs are things that the U.S. economy does as a matter of course. Financial markets will provide, through profitable activities in the gulf area, equity and debt finance. Those firms that bought insurance will receive cash flows that will aid the financing of that, plus they will have some internal resources to aid it, and the Government will provide support for the household sector in the form of relief and has done so through the efforts of the Congress. It has standing authority to provide lots of necessary public infrastructure.

And, if we go to the next chart, it is important to emphasize that there are, in addition to moneys, standing authorities in many of the areas that are central to setting the groundwork for an economic growth recovery in the region. This chart is meant to be illustrative and not exhaustive, but across the top are the various programs and agencies of the Federal Government. Across the left side, moving down, are various activities that are central as one moves through time, from search and rescue and debris removal and temporary assistance to providing housing and public infra-

structure and other parts of the recovery mechanisms such as business loans.

One can see that there is a variety of agencies that have authorities in many areas. As a result, it is a matter of using the broad authorities of FEMA, which cover many of the activities that are important in this effort; the Small Business Administration, which can provide household and business loans that are subsidized by the Federal Government; Housing and Urban Development, which provides housing; the FHA, which can provide some forbearance on mortgages; emergency authorities in the highway area and cash and benefits in food stamps and Medicaid and unemployment insurance.

Much of the authority has already been provided by the Congress; and, as both the chairman and Mr. Spratt noted in their statements, much of the financing, in the form of \$60 billion in the Disaster Relief Fund, for example, is available already at this time.

So the third point I would like to close with is that these hurricanes are unique in some attributes, but disasters in general are not, and they can be included in the regular budget process and approached as a matter of policy.

Families hopefully budget for disasters. They buy insurance and pay the premiums for that insurance, whether it be a homeowner's policy or an auto policy or a health insurance policy, which compete with other demands for the family budget; and they do it in that fashion when they put money aside in a reserve and that way give up other opportunities that they might have to spend that money. In each case, the budgeting process provides trade-offs between budgeting for disaster and doing other activities.

The same can be done in the Federal budget. The chairman and Congressman Cardin had an approach several years back. At a small level, the annual appropriation into the FEMA fund constitutes exactly that kind of an activity.

In the written testimony we lay out a variety of options that the Congress could consider and certainly would be interested in working with the committee on more detailed proposals in this area. In doing that, several kinds of trade-offs become apparent.

The first, and the one that is noted most frequently, is between disasters and other forms of spending—and certainly if disasters are the paramount issue of the moment—it is important that they be prioritized above other activities and vice versa, but doing it in a regularized fashion would also provide some consistency across disasters as well and thus achieve an objective of fairness in addressing the victims of each natural disaster in the same fashion.

And, as laid out in the written testimony, it is also the case that policies can do more than write checks after the fact. Policies can mitigate the cost of disasters by providing appropriate incentives to lower exposure to economic losses in these areas.

So I thank you for the chance for the CBO to be here today. Katrina and Rita are important events. We will learn more about them as time elapses. The Congress will have the opportunity, given the large appropriations that have been made already, to learn more about them before any further action becomes necessary.

I want to echo, in closing, some comments made by both Mr. Spratt and the chairman in the opening remarks. Not everything has changed because of these hurricanes. It remains the case that the U.S. economy is strong and that, as a result, the future path of the U.S. budget will be determined by the policy choices of the Congress and the President and that, prior to these hurricanes and now in the aftermath, the U.S. budget does not line up over the long term and that commitments to spending are far outstripping the revenues on the books to finance them and that that issue remains as part of the ongoing work of this committee.

Thank you for the chance to be here.

[The prepared statement of Mr. Holtz-Eakin follows:]

PREPARED STATEMENT OF HON. DOUGLAS J. HOLTZ-EAKIN, DIRECTOR,
CONGRESSIONAL BUDGET OFFICE

Chairman Nussle, Ranking Member Spratt, and Members of the House Budget Committee, thank you for offering the Congressional Budget Office (CBO) the opportunity to discuss the likely economic and budgetary impacts of Hurricanes Katrina and Rita. Those storms exacted a tragic toll from the people of Louisiana, Mississippi, Alabama, Texas, and Florida and their property. The hurricanes also significantly damaged the nation's near-term energy supply. At this time, the extent of the damage and the costs of recovery are still unclear, but it is evident that recovery in the Gulf region will entail the expenditure of billions of private-sector and taxpayer dollars. That prospect raises important questions about the character and scope of current recovery efforts and about how to prepare and budget for future disasters.

My testimony will make the following points:

- Hurricanes Katrina and Rita have temporarily and significantly reduced the growth of national economic output, but the overall effects that recovery and rebuilding will have on economic activity may more than offset that drag by early next year. Nevertheless, a full recovery in the affected Gulf states will take quite some time.
- Actions pursued thus far by the Federal Government will push the Federal budget further into deficit for the next few years, largely because of the \$62 billion appropriated for emergency assistance but also because of various temporary changes to tax rules. The ultimate impact of the hurricanes on the Federal budget will be determined largely by the actions of the Congress and the President.
- The scale and scope of the damage from Katrina and Rita are unique, but costly natural disasters are not. The Congress may wish to consider options to incorporate planning for such events in the regular budget process. That planning may help evaluate policies for reducing the costs of future disasters and budgeting in advance for a greater share of those costs.

CBO's estimates of economic losses and impacts continue to evolve as new data and analysis become available. The estimates reported in this testimony are updates of those provided in CBO's letter to the budget committees dated September 29, 2005.

ECONOMIC LOSSES FROM HURRICANES KATRINA AND RITA

The economic effects of the hurricanes arise from the loss of life and the destruction of private and government capital stocks in the Gulf states. Hurricane Katrina destroyed considerable numbers of residential structures; consumer durable goods, such as motor vehicles, household furnishings, and appliances; and business structures and equipment, particularly in the energy and petrochemical industries. Hurricane Rita appears to have had a smaller impact on residential structures and consumer durable goods, but its damage to the energy industry may be as great or greater than Katrina's. The damage to capital stocks has temporarily reduced employment and the growth of income in the affected areas.

DAMAGE ESTIMATES

The damage has not been completely surveyed, but it is widely agreed that Hurricane Katrina alone has caused more economic damage than any recent catastrophe in the United States. Estimates from Risk Management Solutions (RMS), a private-sector company that provides services for the management of insurance catastrophe

risk, suggest that total losses—insured and uninsured—from both hurricanes approach \$140 billion, the bulk of which is due to Hurricane Katrina. Insured losses are estimated to range from about \$40 billion to \$67 billion, with recent estimates closer to the lower end of that range.

Losses of physical capital total between \$70 billion and \$130 billion, in CBO's estimation (see Table 1). That amount is smaller than the total RMS estimate because a portion of both the insured and uninsured losses that RMS reports reflect losses arising from claims under business-interruption policies as well as the costs of demolition, cleanup, and repairable damage.

As time goes on, it may be possible to base estimates on the damage that stricken areas have actually experienced, but at present, such estimates are not available. Using the shares of capital by type (fixed capital and consumer durable goods) for Louisiana as a proxy for shares in the whole stricken area, about 25 percent of the damage will have been in housing, more than 45 percent in business structures and equipment, nearly 20 percent in public infrastructure (roads, bridges, sewer systems, and so forth), and almost 10 percent in consumer durable goods. Nearly half of the losses in business structures and equipment will have been in the energy industry.

Housing. The extent of the damage to the housing stock remains unknown. The National Low Income Housing Coalition estimated the number of housing units damaged by Hurricane Katrina using data from the 2000 census and the Federal Emergency Management Agency (FEMA).¹ The number of housing units were matched by census block to FEMA maps that provided estimates of the proportion of units that suffered at least moderate damage. That calculation indicated that about 287,000 occupied housing units were lost or damaged. Of that number, 135,000 units in New Orleans were probably damaged by flooding. Hurricane Rita also damaged thousands of homes, but no reliable estimates are as yet available. Some other measures of the effects of the two storms indicate that more than 400,000 units were damaged, but it is uncertain how those estimates were derived.

TABLE 1.—ESTIMATES OF THE VALUE OF CAPITAL STOCK DESTROYED BY HURRICANES KATRINA AND RITA

[Billions of 2005 dollars]

	Range
Housing	17 to 33
Consumer Durable Goods	5 to 9
Energy Sector	18 to 31
Other Private-Sector	16 to 32
Government	13 to 25
Total	70 to 130

Source: Congressional Budget Office.

CBO estimates that the value of the damage to residential structures—not including relatively minor, easily repairable damage—ranges from \$17 billion to \$33 billion. Under an assumption that about 300,000 units sustained at least moderate damage from the two storms, a comparison of the value of damage estimates with that number of units suggests damage in the range of roughly \$58,000 to \$108,000 per unit.

The Energy Industry. Currently, about 90 percent of crude oil production and roughly 70 percent of natural gas production from the Gulf of Mexico are shut down because of damage to platforms and pipelines that bring those products to shore. (The Gulf's production of crude oil makes up about 2 percent of the world's supply.) After Katrina, the Minerals Management Service reported that the storm destroyed or caused extensive damage to 66 producing structures; initial reports indicate that Rita destroyed or damaged 41 more. Fortunately, most of the high-volume platforms that operate in deep waters and account for nearly half of the Gulf's offshore oil production appear to have escaped significant damage. However, one large platform, the Mars facility, which on its own accounts for 10 percent of Gulf oil production, was damaged badly enough by Katrina to be out of service until early 2006.

¹National Low Income Housing Coalition, Research Note No. 05-02 "Hurricane Katrina's Impact on Low Income Housing Units" (September 20, 2005), available at www.nlihc.org/research/05-02.pdf.

In the petroleum-refining sector, damage from the hurricanes has resulted in the loss of 3 million barrels a day of refining capacity (or nearly 20 percent of the nation's total capacity), but much of that disruption of activity seems to be related to flooding and power outages. Onshore losses of capital for refineries, petrochemical plants, natural gas plants, bulk terminals, and pipelines appear to be smaller than the offshore losses.

The electric power industry in Texas and Louisiana incurred significant damage as a result of the two storms. Although power has been restored to millions of customers, nearly 400,000 in those states remain without power. The industry has already reviewed its losses and claims that the costs of repairing downed transmission towers, substations, and local power lines, as well as recouping lost sales revenues during the period, will total \$2.5 billion.

By CBO's estimate, capital losses in the energy-producing industries will range from \$18 billion to \$31 billion. Those estimates are based on a rough assessment of the value of firms' damaged structures. Capital losses in the energy sector appear to constitute about a fourth of total losses from the two hurricanes.

Government Capital. It is difficult to estimate the storms' toll in damage to government capital, which includes drinking water and sewage treatment facilities, roads and bridges, airports, schools, courthouses, and other public buildings. The status of water systems in the affected areas is not well known, and there are no reliable estimates of the cost of repairing those systems. Similarly, estimates for the repair and reconstruction of other public infrastructure—such as major highways and bridges, locally maintained roads and bridges, and port infrastructure—range in the vicinity of \$10 billion but are highly uncertain.

Because estimates of losses of government capital are lacking, CBO has assumed that about 20 percent of the capital destroyed as a result of the hurricanes was government capital. (That percentage was chosen because it reflects the government share of the total capital stock in Louisiana in 2003.) CBO has estimated the value of the losses in government capital at between \$13 billion and \$25 billion.

LOSSES SUSTAINED IN PREVIOUS CATASTROPHES

The combined losses of Hurricanes Katrina and Rita are likely to surpass those from the costliest hurricane previously on record (Andrew) and the three costliest disasters in recent history (Hurricane Andrew, the September 2001 terrorist attacks, and the Northridge earthquake). The extent of the damage done by the two recent hurricanes suggests that recovery will also take longer than the recoveries from those other large catastrophes.

- Losses from Hurricane Andrew, a Category 5 hurricane that struck about 20 miles south of Miami on September 24, 1992, totaled \$38.5 billion in today's dollars, \$19.2 billion of which was insured. (Those losses include destroyed capital as well as other losses.) About two-thirds of the dollar amount of all claims—approximately \$12.5 billion—was paid to holders of homeowner's policies. Commercial policies accounted for most of the remaining one-third of insured losses.

- The losses from the terrorist attacks on September 11, 2001, are estimated at \$87 billion in today's dollars. Privately insured losses are estimated to total \$35.2 billion and include \$11.9 billion in business-interruption losses, \$10.4 billion in property losses, \$3.8 billion in aviation liability, \$1.9 billion in workers' compensation benefits, and \$1.1 billion in life insurance payments. (Another \$1.1 billion in property losses remains in dispute.)

- The earthquake that struck Northridge, California, on January 17, 1994, measured 6.7 on the Richter scale and resulted in damages of \$48.7 billion in today's dollars. Of that amount, \$18.8 billion was insured. Claims under homeowner's policies constituted more than three-quarters of the total dollar value of the insured claims. Those claims might have been far more extensive, but only 40 percent of homeowners carried insurance coverage for earthquake damage.

INCOME LOSSES IN THE GULF STATES

The losses in the capital stock have largely shut down economic activity in New Orleans and have hampered activity in parts of the other states affected by the hurricanes. Employment and wage income have fallen as have state and local tax revenues. As rebuilding efforts gain force and economic activity begins to recover, employment, incomes, and state and local revenues will also recover.

Employment and Wage Income. Excluding people whose work was disrupted only for a few days, the combined direct effect of Hurricanes Katrina and Rita on employment was probably the loss of between 293,000 and 480,000 jobs. Moreover, the two storms' effects on general economic activity mean that employment will be temporarily depressed—for the nation as a whole as well as in the stricken areas.

Measuring the effects of the hurricanes on employment will remain difficult, even after the Bureau of Labor Statistics begins to publish data for September later this month. In particular, the bureau faces considerable problems in measuring employment in the storm-damaged areas. The effects of Rita will not be reflected in the data for September but should appear in those for October (which will be published in November).

Direct Effects of Katrina. Between about 280,000 and 400,000 people lost jobs directly because of Hurricane Katrina. The lower bound for those job losses comes from the number of storm-related claims for unemployment insurance filed to date. The Department of Labor estimates that by September 24, a total of 279,000 such claims had been filed, but that number could go higher. (One potential source of future claims is workers who have so far remained on their employer's payroll, even though unable to work, but who may be dropped if the business does not recover quickly enough.)

CBO based the upper bound of the job-loss total on information from the Bureau of Labor Statistics' report of data for 2004 (using the Quarterly Census of Employment and Wages). That report includes the number of establishments, total employment, and total wages in areas affected by Katrina, which can be used to estimate the jobs potentially at risk because of flooding and other damage and thus an upper bound of the storm's possible effect on employment. In the 86 counties or parishes designated by FEMA as eligible for both individual and public disaster assistance, employment before the storm totaled 2.4 million jobs (1.9 percent of the national total). In 2004, the wage bill for those counties, in which people may have missed a week or more of work, was \$76.7 billion (1.5 percent of the national total).

Workers in the areas that FEMA has identified as flooded and storm damaged are the most likely to experience an extended absence from work (or even to lose their old jobs permanently). According to the Bureau of Labor Statistics, in the fourth quarter of 2004, about 22,500 business establishments within those areas employed roughly 373,000 workers and paid \$3.5 billion in wages and salaries. (Those wage data are also quarterly, not annualized.) Most of the at-risk employment in Louisiana is in flooded areas, whereas in Mississippi, virtually all of the potential job losses are likely to be attributable to damage rather than flooding. In addition, jobs located at some distance from storm-damaged areas may also be at risk: about 265,000 workers were employed within half a mile of such areas in Louisiana and Mississippi—184,000 of them in Louisiana. The upper-bound estimate of job losses of 400,000 assumes that most of the roughly 300,000 jobs in flooded areas plus a fraction of those either in nonflooded areas or within half a mile of flooded areas will be lost.

Direct Effects of Rita. Hurricane Rita's impacts on employment appear to have been considerably smaller than those of Hurricane Katrina. Within areas identified by FEMA as having been damaged by Rita, employment in the fourth quarter of 2004 totaled about 12,600 jobs, with a wage bill for the quarter of about \$115 million (not an annualized figure). Because information on unemployment insurance claims attributable to Hurricane Rita is not available, the 12,600 figure represents a lower bound on the number of jobs at risk of prolonged disruption (although some of those workers are probably still being paid by their regular employers and others may have been hired to participate in cleanup activities). However, nearly 140,000 people were employed within half a mile of those damaged areas; under the assumption that half of those jobs are also at risk of prolonged disruption, CBO estimates an upper-bound impact on employment of roughly 80,000 jobs.

Aside from those effects, the evacuation of more than 2 million residents from the Houston metropolitan area probably resulted in the loss of a few days' pay for some workers and reduced profits for employers who continued to pay their workers. (Such effects will not show up in the October employment data.) In addition, renewed flooding in portions of New Orleans and St. Bernard Parish might slightly delay the recovery from job losses attributable to Katrina, although it should have no impact on employment totals by the end of the year.

Revenues of State and Local Governments. Data from the state of Louisiana are especially difficult to acquire, but that state is expected to face the most severe revenue problems of all of those affected by the hurricanes. Early information from Mississippi, Alabama, and Texas indicates that state general fund revenues may not suffer significantly as a result of the storms. Some local governments may confront more-serious difficulties because they face significant losses in their property tax bases a development that also raises the risk of defaults on their municipal bonds. Louisiana and Mississippi are working to help local governments make payments on their bonds.

Louisiana officials are still gathering information about the storms' effects on the state's budget. Most unofficial estimates of lost revenues have ranged from \$1 billion

to \$3 billion, a significant shortfall given that the governor's budget recommendation for 2006 was based on the assumption that state revenues would total about \$12 billion. Local governments, particularly that of New Orleans, have lost significant portions of their tax bases—notably, revenues from property taxes. About two-thirds of the population of Louisiana lives in areas that are now officially declared disaster areas. In the affected parishes, annual property taxes totaled about \$1.3 billion and local sales taxes, about \$1.8 billion; together, they accounted for about 70 percent of statewide tax collections.

In Mississippi, the storms' net effect on the state's general fund over time is likely to be negligible. Despite the fact that about two-thirds of the Mississippi population lived in an area that has now officially been declared a disaster area, initial reductions in revenue resulting from lost income and wages and some decrease in gaming activities are not expected to be as large as in Louisiana. Moreover, those reductions will be balanced by increased collections from income taxes, as cleanup continues and rebuilding efforts begin. Affected counties in Mississippi collect about \$1 billion in property taxes.

Although the Gulf coasts of Alabama and Texas were hit by both hurricanes, those states are not anticipating any long-term effect on revenues. The 10 counties in Alabama affected by the storms hold about 18 percent of the state's population; in Texas, the affected areas hold about 4 percent. In those states, the primary effect on revenues will be reductions (if any) in income taxes as a result of lost wages.

THE SCALE AND PACE OF RECONSTRUCTION SPENDING

The overall pace of reconstruction after the hurricanes is likely eventually to be quite rapid, although significant delays and bottlenecks could occur in the rebuilding effort and insurance settlements in some affected areas could be somewhat slower than they have been in past disasters. Spending for rebuilding and replacing privately owned structures, equipment, housing, and consumer durable goods (that is, total private replacement and rebuilding) could rise to between \$20 billion and \$40 billion (in 2005 dollars, measured annually) by the first half of 2006. Almost a third of such spending would be in the energy sector; another third would be in residential construction. The rebuilding of government capital facilities would add to that reconstruction activity.

HOUSING

The scale of the devastation from the two storms suggests that a substantial demand for construction services will emerge, but the problems associated with rebuilding in New Orleans will delay and perhaps mute that response. Although the speed of repair and rebuilding is always constrained by the availability of funds and workers, residential construction is likely to add about \$2 billion (measured annually) to economic activity in the last half of 2005, CBO forecasts, and about \$10 billion in the first half of 2006. Those numbers, which represent the midpoints of the range of CBO's estimates, cover all construction associated with the storms, regardless of where it takes place. (Some homeowners may not rebuild on their original site but instead use the insurance payments they receive to build or buy a home elsewhere.)

The midpoints of CBO's estimates incorporate the assumption that it will take 3 years to fully rebuild the housing stock. A 2-year rebuilding period is commonly used in such estimates, but CBO used a more conservative time frame because the rebuilding of New Orleans poses unique problems. It appears that property insurance compensation (private and flood insurance) and various grants and low-cost loans will be timely enough to support such a pace of rebuilding.

THE ENERGY SECTOR

Levels of oil and natural gas extraction may be lower than usual through the middle of 2006, but the bulk of the Gulf coast's pipeline and refinery operations will probably be repaired by the end of this year. The pace and scale of repairs will become clearer in the near future as assessments of damages to Gulf drilling and undersea pipelines become available. The largest offshore facilities may be able to resume operations in the next few weeks; if they can, oil and natural gas production from the Gulf of Mexico may average half its normal level for the rest of this year. Other offshore facilities will probably return to production during the first half of 2006.

Operators of refineries anticipate that damage from the storms can be repaired within a few weeks, but that recovery will depend on the speed of the restoration of electric power. (Complete restoration of electricity service may require another

month or more.) National refinery production may be reduced by roughly 10 percent, on average, for the rest of this year, but it is likely to be at 100 percent capacity by year's end. A similar pace of recovery is likely for the region's large number of petrochemical complexes, natural gas processing plants, and natural gas pipelines.

OTHER INDUSTRIES

Restoration of damaged structures and equipment—known as business fixed investment in industries other than energy—is also likely to stimulate economic activity. If the private capital stock is rebuilt in an average of three to 4 years (a standard assumption), such spending will add \$5 billion to \$10 billion to business fixed investment in 2006, the bulk of which is likely to be purchased from domestic suppliers.

GOVERNMENT

Much of the repair work to public-sector capital, such as the work on the I-10 Twin Spans Bridge across Lake Pontchartrain and the pumps for New Orleans, started immediately after Hurricane Katrina in order to facilitate rescue and recovery operations. Federal funding will contribute to the repair of roads and water treatment facilities, although the scale of public rebuilding will be much smaller than that of the private sector.

EFFECTS ON NATIONAL OUTPUT, EMPLOYMENT, AND INFLATION

The economic effects of the destruction wrought by the two recent Gulf hurricanes will be more pervasive than those of previous hurricanes and will affect the nation's economic activity for the balance of this year and all of next year. Hurricanes Katrina and Rita were unique in the scope of their destruction, the disruption of energy supplies, and the dislocation of workers. The storms have temporarily reduced the growth of economic output, but the effects of rebuilding on economic activity may more than offset that drag by early next year.

At this time, it is still too early to know the degree to which economic activity will slow this year and how quickly it may recover. Factors that will affect the speed of recovery are how quickly insurance and government payments are distributed, how quickly consumer energy prices decline, and how quickly rebuilding starts, in New Orleans and elsewhere. For example, if, during 2005, about half of the private insurance claims are paid out; if Federal relief and recovery spending totals about \$10 billion (in the form of transfer payments and outlays for goods and services); if gasoline prices fall back to levels only about 10 percent higher than their pre-Katrina levels; and if rebuilding is only slightly delayed relative to the timing experienced in previous hurricanes, then the economic dislocation of the hurricanes is likely to be offset by the reconstruction effort by early next year.

EFFECTS ON THE GROWTH OF GROSS DOMESTIC PRODUCT

The hurricanes' initial effects on economic output stem from lost production in the affected regions and the temporary spike that has occurred in energy costs. Looking forward, however, the impact of the hurricanes on the pace of production and income will depend on what happens to four major categories of spending: investment (in business structures and equipment, commercial structures, and housing); spending on consumer durable goods; government spending for goods and services; and other household consumption expenditures (see Table 2).

CBO estimates that the hurricanes may reduce real (inflation-adjusted) growth of GDP in the third quarter of 2005 by between 1 and 1½ percentage points, but as cleanup and repair begin, the economy in the fourth quarter is likely to grow at a rate not much different from what it would have been without the hurricanes and possibly even a little higher. Real GDP growth for the two quarters together—that is, for the second half of 2005 as a whole—is likely to be dampened by about half a percentage point. By the first quarter of 2006, though, spending to repair or replace the capital stock (homes, business structures, and equipment) is likely to drive the level of output back roughly to its previous trend and to continue to add slightly to growth during the rest of that year.

CBO's analysis does not include any dynamic feedback effects—that is, the tendency of increased spending in one area of the economy to increase incomes, and consequently spending, elsewhere. Such effects are likely to be small, particularly if the Federal Open Market Committee of the Federal Reserve does not alter its apparent plan to raise interest rates. (The Federal Reserve increased rates by 25 basis points, or a quarter of a percentage point, on September 20, as had been expected before Hurricane Katrina.)

EFFECTS ON EMPLOYMENT

The storms' effects on employment include not only their direct effects (the loss of between 293,000 and 480,000 jobs in the areas struck by the hurricanes) but also the negative impact of the energy shock-induced reduction in consumer demand and the positive impact that will accompany cleanup and rebuilding. The boost in energy prices that arose largely in the storms' wake is tempering the growth of consumption and GDP nationwide. Higher energy prices will dampen employment growth as well, compared with what it would have been in the absence of Katrina and Rita. By contrast, the reconstruction activity, which has already begun, will spur a huge demand for workers by early next year.

TABLE 2.—ESTIMATED NET EFFECT OF HURRICANE KATRINA ON REAL GROSS DOMESTIC PRODUCT
[Billions of 2005 dollars at annual rates]

	2005		2006		2007	
	2d Half	1st Half	2d Half	1st Half	2d Half	1st Half
Energy Production	-18 to -28	-8 to -10	-5 to -7	-5 to -7	-5 to -7	-5 to -7
Housing Services	-1 to -2	-2 to -4	-1 to -3	0 to -2	0 to -2	0 to -2
Agricultural Production	-1 to -2	0	0	0	0	0
Replacement Investment	6 to 12	16 to 34	16 to 35	16 to 35	12 to 25	12 to 25
Government Spending on Goods and Services	6 to 10	12 to 18	14 to 20	10 to 16	7 to 11	7 to 11
Effect of Higher Energy Prices on Nonenergy Consumption	-6 to -10	-5 to -7	-2 to -5	-1 to -3	0 to -2	0 to -2
Other Consumption	-8 to -12	-2 to -4	-1 to -3	-1 to -3	0 to -2	0 to -2
Real GDP	-22 to -32	11 to 27	21 to 37	19 to 36	14 to 23	14 to 23

Source: Congressional Budget Office.

Note: This table is an updated version of a similar table published by CBO on September 29, 2005. The estimates for "Replacement Investment" have changed slightly since that time.

On balance, it is likely that the pattern of employment over the next year and a half will follow the pattern forecast above for GDP. The storms' initial adverse impact on the national level of employment will fade over the next few months, as many employees return to their former jobs or find new ones. By early next year, the pace of reconstruction will probably cause the net effect of the hurricanes on jobs nationwide to be minimal. If, as appears likely, output bounces back by early next year to equal or exceed its previous trend, total employment will be similar to what it would have been if the hurricanes had not occurred, even though some of the people who lost jobs may remain unemployed for some time.

EFFECTS ON INFLATION

Consumer prices will grow at a faster rate during the second half of this year than had previously been expected, CBO forecasts, primarily because of the increase in energy prices. However, inflation should revert to pre-Katrina rates in the first half of 2006, provided—as most analysts anticipate—energy prices ease and drop part of the way back to their levels before the hurricane. Higher prices for construction materials and higher energy prices, through transportation costs, will tend to temporarily increase growth in the prices of many non-energy-related goods as well as in airline, bus, and railroad fares.

The direct, short-term effects of the hurricanes on the rise in the consumer price index for urban consumers (CPI-U)—that is, the effects stemming from the increase in energy prices—will be substantial. As a result of those direct effects alone, growth of the CPI-U between the fourth quarter of 2004 and the fourth quarter of 2005 may be almost 1 percentage point higher than it would have been in the absence of the hurricanes. Nevertheless, inflation as measured by the CPI-U may be slightly lower than previously anticipated during 2006, as the effect of the hurricanes on energy prices dissipates.

GOVERNMENT ACTIVITY AND AUTHORITY FOR DISASTER RELIEF AND RECOVERY

The public-sector response to disasters such as Hurricanes Katrina and Rita involves a mix of funding and personnel from government agencies at the federal, state, and local levels. Federal agencies respond to natural disasters under both standing authority and specific legislative direction.

THE FEDERAL EMERGENCY MANAGEMENT AGENCY

FEMA is the Federal Government's lead agency in responding to natural disasters. When emergencies occur, local jurisdictions are generally the first responders. But when a hurricane or other catastrophe overwhelms both the local and state governments, the governor can request that the President declare a "disaster" or a "major disaster." The President's declaration puts into motion long-term recovery programs to help individuals, businesses, and public entities that are victims of the disaster. Authority to declare a disaster and provide relief is provided by the Robert T. Stafford Disaster Relief and Emergency Assistance Act (the Stafford Act).

FEMA identifies two main categories of disaster aid under the Stafford Act: individual and public assistance. Individual assistance begins immediately after the President declares a major disaster. It may include providing housing, food, and other basic needs for survival and distributing funds to meet needs that insurance companies and other aid programs do not cover. Those may include the repair of homes, replacement of personal property, transportation, medical care, and funeral expenses. FEMA may also provide unemployment benefits and reemployment services to people who are not covered by other unemployment compensation programs, as well as assistance with rental or mortgage payments for as long as 18 months. The Stafford Act currently limits cash assistance to an individual or a household to \$26,200, an amount that is adjusted annually for inflation.

Public assistance consists of grants to state and local governments to help cover the cost of repairing, rebuilding, or replacing infrastructure. It may also support debris removal, emergency protective measures, and the provision of public services. Certain types of nonprofit organizations may also qualify for public assistance if they provide education, utilities, irrigation, emergency care, or other essential services to the general public.

FEMA performs much of its work on a reimbursable basis; that is, it arranges for other agencies to provide goods or services and reimburses them for their costs. For example, state agencies usually administer disaster unemployment assistance, and FEMA often works closely with the Department of Defense and the Army Corps of Engineers to address a community's infrastructure needs.

Over the past 50 years, the Congress has gradually expanded FEMA's authority under the Stafford Act, sometimes as a result of a specific event. For example, following the terrorist attacks on the World Trade Center of September 11, 2001, the Congress authorized FEMA to reimburse New York City for economic losses from reduced tourism, a cost that would not ordinarily qualify for reimbursement. FEMA also has broad discretion in how it administers programs under the Stafford Act, and after September 11, the agency expanded the eligibility guidelines for many of its programs.

To date, the President has requested and the Congress has appropriated \$62.3 billion in emergency assistance in response to Katrina. Almost all of that amount—\$60 billion—was provided to FEMA's disaster relief account; as a result, some of those funds may be used if necessary for assistance in response to Hurricane Rita or other disasters. (That account also held about \$2 billion in unobligated funds provided in previous appropriations.) CBO estimates that outlays from those supplemental appropriations will total about \$30 billion in fiscal year 2006 and that most of the remaining money will be spent over the following 3 years. Although billions of dollars were obligated in September (that is, during fiscal year 2005), most of the checks are likely to be written in subsequent months. The bulk of the spending on reconstruction activities will occur over a period of several years.

As of September 27, FEMA had obligated about \$14.5 billion for activities related to Hurricane Katrina and had allocated another \$3.8 billion for obligation in the future. Of that \$18.3 billion, \$8.0 billion has been allocated to housing assistance and the acquisition of manufactured housing, \$3.5 billion has been committed to states in the form of goods and services for relief activities, and \$3.5 billion will be used to reimburse other Federal agencies—in particular, the Army Corps of Engineers and the Department of Defense (DOD)—for their disaster relief efforts. (Those agencies have also received funding of their own: the Congress provided \$400 million to the Corps and \$1.9 billion to DOD for costs associated with the deployment of military personnel in support of relief efforts, for the evacuation of military personnel and their families, and for short-term repairs to military facilities.)

In addition to the disaster relief fund, FEMA also administers the National Flood Insurance Program. Premiums provide most of the resources to pay claims under that program, which also has the authority to borrow from the Treasury if those amounts are not sufficient. Shortly after Hurricane Katrina, the Congress increased the program's borrowing authority by \$2 billion, bringing the total authority to \$3.5 billion. Although CBO does not have sufficient information at this time to estimate

the total value of the hurricane-related claims that FEMA is likely to face, information from the agency about the amount of flood insurance in force in affected areas suggests that those losses will significantly exceed the sums currently available to pay claims. CBO expects that the agency will exhaust its existing resources quickly, bringing net outlays for the program to almost \$4 billion. At that point, additional funding is likely to be necessary to enable the program to quickly pay outstanding claims.

By one measure, the Federal Government has committed a historically high level of resources for relief and recovery from Hurricanes Katrina and Rita. The recent emergency supplemental appropriation of more than \$60 billion is almost double the emergency supplemental appropriation provided for the September 11, 2001, terrorist attacks and more than 10 times the emergency appropriation after Hurricane Andrew.

OTHER CONGRESSIONAL ACTION TO DATE

In addition to supplemental appropriations for disaster relief, the Congress and the President have enacted a number of other laws to assist those affected by the hurricanes. The TANF Emergency Response and Recovery Act of 2005 (Public Law 109-68) provides additional funds to states that were damaged by Hurricane Katrina and those that are hosting evacuees from the hurricane to provide benefits to needy people. That legislation will cost about \$400 million, CBO estimates, mostly in 2006. The Congress and the President have also enacted laws authorizing flexibility in the use of disaster aid for displaced workers, changes to student loan programs, and priority funding for programs to aid individuals with disabilities. Much of the costs of those activities will be paid for with previously appropriated funds, but about \$260 million will flow from the reappropriation of funds that otherwise would not have been spent.

The Katrina Emergency Tax Relief Act of 2005 (Public Law 109-73), which was enacted on September 23, provides tax relief in a number of ways to businesses and individuals. The Joint Committee on Taxation estimates that the law will reduce revenues by about \$6 billion, almost entirely over fiscal years 2006 and 2007. The provisions with the biggest effects on revenues allow taxpayers to deduct more personal property losses from taxable income, allow taxpayers more time to replace damaged property without being assessed income taxes on the insurance proceeds, and allow businesses and individuals to deduct more charitable donations from taxable income.

THE ROLE OF OTHER FEDERAL DEPARTMENTS AND AGENCIES

A number of other Federal agencies can and do assist individuals, businesses, and local governments affected by a disaster.

Loans to Individuals and Businesses. The Small Business Administration (SBA) makes subsidized loans to residents and businesses in a disaster area. Homeowners may borrow up to \$200,000 to repair or replace their home, and SBA provides loans of up to \$40,000 to renters and homeowners to cover losses to personal property, such as clothing, appliances, and furniture. SBA provides loans of up to \$1.5 million to businesses to cover damages to their physical property, and the agency also lends money to businesses that have suffered economic injury as a result of a disaster and need help paying their bills or meeting operating expenses.

In 2005, SBA's disaster loan program received a supplemental appropriation of \$501 million, and the President requested \$83 million for fiscal year 2006. In the Federal budget, entries for such funds reflect the net value of the Federal subsidy over the life of the loans. CBO estimates that the appropriated credit subsidy provided for 2005 will support a total loan level of \$3.9 billion.

Temporary and Permanent Housing. Following past disasters, the Congress has transferred FEMA resources or appropriated new funding for the Department of Housing and Urban Development (HUD) to assist individuals in their transition from emergency shelter to permanent housing options using existing HUD programs. Individuals may receive direct assistance through the Section 8 housing choice voucher program or through public housing, and states may use funds from the community development block grant (CDBG) and the HOME Investment Partnership programs to repair damaged homes and finance long-term redevelopment. After the five hurricanes in August and September 2004, for example, HUD provided \$26 million in emergency funds to repair public housing units, \$10 million to repair housing units for the elderly and the disabled, \$40 million in additional Section 8 vouchers, and \$16 million to relocate displaced families. In addition, the Congress appropriated \$150 million in additional CDBG funds for states.

A presidential disaster declaration allows the Federal Housing Administration (FHA) to call for a 90-day moratorium on foreclosures of FHA-insured mortgages. The agency may also encourage FHA mortgage lenders to offer special forbearance to affected borrowers and may relax its underwriting guidelines to permit disaster victims to qualify for certain loan programs that provide 100 percent financing for the cost of reconstruction or for replacement residences when residences have been destroyed or severely damaged by the disaster.

Rebuilding or Repair of Roads and Bridges. State and local governments receive assistance for rebuilding roads and bridges that are part of the Federal-Aid Highway system through the Emergency Relief (ER) program of the Federal Highway Administration (FHWA). The ER program has direct spending authority of \$100 million per year; however, the FHWA currently reports about \$124 million of unfunded requests for aid through the program and anticipates that additional requests—not including those related to Hurricanes Katrina or Rita—will total more than \$500 million. Currently, the FHWA has no estimate of how much the damage caused by those hurricanes will add to its backlog. The recent highway act (Public Law 109–59) authorized the appropriation of additional sums as necessary for the ER program, although to date, no additional funds have been appropriated. In 2005, the Congress appropriated \$1.2 billion for that program for emergency expenses resulting from the 2004 hurricanes.

Restoration of Public Water Systems. The Department of Agriculture has two programs for rebuilding public water systems after disasters. The Emergency Watershed Protection Program provides funds to state and local governments to remedy emergency situations in local watersheds that present substantial danger to the public health. Spending is dependent on emergency supplemental legislation. In 2005, Florida received \$120 million to repair damage and remove watershed debris caused by the 2004 hurricanes. Funds from the Emergency and Imminent Community Water Assistance Grant Program are available only to rural areas; the Congress appropriated \$23 million in 2005 for such grants. In addition, public water facilities receive loans from state revolving funds that are eligible for grants from the Environmental Protection Agency, and some of those loans may be available to repair hurricane damage.

Cash Benefits and Other Assistance. The Federal Government operates assistance programs that automatically respond in emergencies to the loss of income and other services, and many agencies have the authority to waive certain program requirements in the event of disasters. The loss of employment in areas affected by the hurricanes will result both in emergency unemployment benefits paid through FEMA (as mentioned above) and increased claims for regular state unemployment benefits, which CBO expects could reach \$600 million in the coming months. Likewise, emergency Food Stamp assistance is available through at least October, and school children dislocated by the storms will receive free school lunches and breakfasts through the child nutrition program regardless of whether they had to pay some or all of the costs of meals before the storms. Higher expenditures for Medicaid in the coming months can also be expected because the employment and income losses resulting from the storms will increase the eligible population.

Some Federal agencies can waive program rules for a limited period after a disaster. For example, in 2004, the Secretary of Education announced a policy of forbearance regarding interest on student loans for borrowers affected by hurricanes and other catastrophic events. For some assistance programs, rules for documenting and verifying the income and resources of applicants have been loosened pursuant to existing administrative authority.

The effects of the hurricanes will also be felt by recipients of the major cash benefit programs. The surge in energy prices will increase consumer inflation for September and as a result boost the annual cost-of-living adjustments to those programs' benefits in January 2006 by perhaps 0.3 percentage points. Such an increase would increase spending in 2006 by \$1.6 billion.

STATES' EMERGENCY RESOURCES

Like most states, those affected by Hurricanes Katrina and Rita have procedures for funding disaster assistance programs that parallel current Federal practices; that is, state legislatures typically appropriate small sums to emergency-response accounts annually. None of the states provides funding in advance for those accounts at a level sufficient to cover large-scale emergencies, a practice that reflects the expectation that the Federal Government will step in to help when large-scale disasters occur.

States tend to plan for two types of fiscal emergencies: economic downturns and natural disasters. States establish a variety of contingency and emergency accounts

(referred to in one state as the Stormy Day Fund) to prepare for unforeseen disasters, either natural or man-made, which can occur at any time. The purpose of those accounts is to earmark money for emergencies or other unanticipated or hard-to-estimate one-time expenditures that may occur within a given fiscal year. For the most part, the amounts allocated are relatively small, requiring the governor to go to the state legislature in the event of a large-scale emergency. Occasionally, a governor has the emergency authority to bypass the legislature entirely and borrow from almost any other state budget account. In Louisiana, for example, policy states that funds for disasters and emergencies are always to be available; the governor, in effect, has the authority to borrow from any appropriated funds to address an emergency.

The amount of money that states commit to emergency accounts varies greatly, ranging from a few hundred thousand dollars to several hundred million dollars. Louisiana has an Interim Emergency Board fund into which up to 0.1 percent of total state revenue collections can be appropriated. For fiscal year 2005, the fund contained \$15.5 million. The state also has an Oilfield Site Restoration Fund, which contained \$8.4 million in 2005, and an Environmental Trust Fund, which contained \$69 million.

Mississippi does not have a statutorily created emergency fund; it does, however, have an Emergency Management Agency that administers a disaster relief fund. In fiscal year 2005, the Emergency Management Agency's budget was just under \$1 million, and the Disaster Relief fund contained about \$1.6 million. The goal in most states is to have enough money in those types of emergency accounts to provide the necessary match for Federal disaster assistance.

GOVERNMENT POLICY AND THE RESPONSE TO DISASTER

September's hurricanes inflicted tragic amounts of human misery and loss of life. Together, they were unique in the scale and scope of dislocation, destruction of physical capital, and loss of income. However, investing in new capital and raising the standard of living are things that the U.S. economy does as a matter of course. The financial markets, as they always do, will steer debt and equity investments to profit-making opportunities. In addition, payouts on insurance contracts will serve as a source of funding for new investment as well as provide compensation for some of the lost capital. And given government support for necessary public infrastructure, as discussed above, many of those attractive investment opportunities will be found in the affected areas of the nation's Gulf coast. The effects of Katrina and Rita do not require a major reexamination of Federal policy toward national or regional economic growth.

The magnitude of the Federal response to Katrina and Rita and the recurrent nature of natural disasters do raise related policy issues: the financing of current Federal assistance and budgeting for future disaster aid, and options for reducing the costs of future disasters.

BUDGETING FOR RECENT AND FUTURE DISASTERS

The Federal Government's additional spending for disaster assistance in the wake of Hurricanes Katrina and Rita will ultimately be paid for through some combination of reductions in other Federal spending and increases in tax revenues, either now or in the future. An important issue for policymakers is the extent to which payment for the current assistance should be made now rather than postponed through an increase in the deficit.

Beyond that decision lies the question of how to budget for the costs of future disasters. Under current practice, most Federal funding of disaster assistance is provided through supplemental appropriations that are enacted as emergencies arise. Emergency supplementals require no offsetting rescissions (cancellations of previously provided budget authority) and are typically provided without lengthy legislative delays. Consequently, Federal assistance can be quickly provided to disaster victims and state and local governments. However, many analysts believe that current Federal budget procedures can lead to inappropriate evaluations of the trade-offs involved in providing assistance and can reduce incentives for mitigation and recovery efforts by state and local governments. Encompassing disaster aid within the regular budget process of weighing Federal spending priorities could lead to more-deliberate evaluation of standards of need and more consistent incentives for state and local governments and businesses to cover their losses.

Federal budget procedures could make the real costs of current disaster policy clearer. One option—similar to the approach the Congress uses to fund Federal fire-fighting programs—would be to appropriate money for disaster programs in regular appropriation bills in amounts equal to the expected funding need for each program.

(As a string of expensive emergency supplemental bills for natural disasters over the past 15 years demonstrates, spending on disasters has a predictable component.) Under such an option, unused funds would be available with no further action by the Congress when needs arose. Increasing regular appropriations would reduce, but certainly not eliminate, the need for emergency supplemental appropriations.

Another option would be to use annual appropriations to create a rainy-day fund to cover future expenses for Federal disaster relief. Spending from such a fund could be made subject to further Congressional action when a need arose an important difference from the preceding option. Thus, the Congress could retain greater control over the use of the funds.

Almost all states have some kind of contingency or emergency account; however, few provide funding in advance for those accounts at a level sufficient to cover large-scale emergencies. Furthermore, most states count on the fact that the Federal Government will step in with assistance when large-scale disasters occur. A major hurdle for the success of a rainy-day fund at the Federal level therefore would be to preclude the use of the fund for other purposes, as has happened at the state level.

REDUCING THE BUDGETARY AND ECONOMIC COSTS OF FUTURE DISASTERS

Policymakers may also wish to consider options to reduce the costs of future disasters. Although the underlying natural forces cannot always be controlled, it is possible to adapt investment strategies and economic activities to reduce the financial and personal toll such forces may exact.

One goal calls for minimizing the sum of four types of costs associated with disaster risks: disaster losses, the costs of reducing those losses through mitigation (used broadly here to include preparedness and “passive mitigation” that simply forgoes risky activities), the administrative costs of reducing uncertainty through insurance, and the psychic costs of the remaining uncertainty. A second objective is to allocate disaster costs fairly.

The two basic approaches for controlling the costs of future disasters—mitigation and insurance—work in different ways. Mitigation seeks to reduce injuries, deaths, and physical destruction by avoiding exposure to hazards, improving disaster resistance, and making plans to minimize losses after the event through timely and effective responses.² By contrast, insurance does not reduce the damage caused by an event but spreads the costs of that damage to reduce the financial burden on the victims. To some degree, the two approaches are substitutes for each other: the more mitigation reduces exposure to risk, the lower the demand for insurance; conversely, the more complete the insurance coverage, the lower the incentive to undertake mitigation and avoid risky activity. The two approaches work best together when insurance premiums can be finely tailored to individual risks. In that case, policyholders who take effective mitigating action see the full financial benefit of their efforts through discounts in their premiums. Conversely, insurance prices that poorly reflect actual risks—especially insurance that is subsidized, or even free—undermine mitigation incentives the most.

Implicit or explicit insurance subsidies are a major feature of current Federal disaster programs. In the National Flood Insurance Program (NFIP), explicit subsidies are given to policies on structures built before the issuance of a participating community’s flood rate map or before 1975, whichever is later (and not “substantially damaged” or “substantially improved” since then). Although those subsidies are not a factor in encouraging new development in flood-prone areas, they probably do tend to retard the rate at which residents and businesses move out of existing structures, thus keeping the level of risk and the likely cost of future disasters higher than they would be otherwise.

Other Federal subsidies for disaster insurance are implicit, but they still have the effect of supporting risky behavior and discouraging mitigation. One example is assistance to individuals and businesses beyond payouts on flood insurance claims—for example, low-interest reconstruction loans from the Small Business Administration. Another example is FEMA’s Public Assistance program, in which the Federal Government pays a minimum of 75 percent of the eligible cost to rebuild public facilities owned by state and local governments, Indian tribes, and certain nonprofit organizations. Both of those programs effectively provide a form of unpriced insurance.

A detailed analysis of the incentive effects and implications for efficiency and equity of current Federal programs and alternative policy options is beyond the scope

²However, mitigation can never eliminate all risks of loss from all sources, and a particular project may be counterproductive if the residual risk is not acknowledged and taken fully into account.

of this testimony. However, three categories of available options can be sketched out.

- The government could try to promote efficient mitigation and risk sharing by looking for ways to strengthen the market for private insurance. Current regulation at the state level often keeps premiums below actuarially expected losses in high-risk areas to keep insurance “affordable.” In addition, Federal tax laws discourage the private provision of disaster insurance by not allowing the accumulation of reserves in advance of catastrophic events.

- The government could try to lessen the incentives it now provides for risky behavior. For example, it could phase out the NFIP subsidies on grandfathered properties, charge user fees for the implicit insurance it now provides to individuals and businesses in high-risk areas, or reduce the Federal share of costs in the Public Assistance program, particularly for projects to rebuild structures that would remain exposed to the high risk of damage in future disasters.

- The government could go beyond reducing disincentives to mitigation in its own disaster programs by providing more funding for mitigation or by imposing new mitigation requirements.

Chairman NUSSLE. Thank you, Director Holtz-Eakin. Your testimony confirmed a lot of the work that you have been doing. You have kept in good touch with us in the Congress and the Budget Committees, and I appreciate the work that you and CBO have done to give us the information. It is not easy at all to make the kinds of predictions or judgments about how things are going in the midst of these disasters as they unfold, but you have done that, and they have been very helpful as we have moved forward.

Your discussion of the family budget, it should not be all that revealing to us, but it really is, and it should give us all pause. Because we, as family members of this Federal budget, sitting around the kitchen table trying to decide as a family and as a Nation how to deal with this, no different than any family, are not allowed to just push their chair back from the table and walk away and say I do not like your plan. I do not like your ideas, or your plan is no good. If you want to be a responsible member of the family, you need to present your options.

If you do not like the spending cuts, then tell us where you want to cut spending in other areas. If you don’t like the programmatic performs, then tell us how you would reform the programs. If you don’t believe any spending reductions are in play or necessary, than tell us how you are going to raise taxes.

But to just look at the plan and to say it is no good—and I will admit, I put a plan on the table. I understand the first person to stick their head out of the foxhole is going to get shot at. That is fine, go ahead, but shoot with your options. Shoot with your plans, and your family budget discussion I think was an excellent one.

Second, in just a brief response to my friend, Mr. Spratt, who talked about the difference between planning for and paying for Biloxi versus Baghdad. I could not agree more, which is the reason why we did budget for Baghdad, in addition to what I am suggesting now is budgeting for Biloxi, and it is a very serious effort.

I was very frustrated with the administration’s unwillingness over the last number of years to budget for what we believed—we at least had some inkling—was going to be the cost of the war; and that is the exact reason why we did budget for Baghdad. We have found the offsets in this process, as we have not only held the line on spending but we have put pro-growth policies in place that got us \$100 billion worth of savings as a result of growth in the economy from this year alone.

So we have budgeted for the war on terror. It is not perfect, it is a down payment only. It is rare that you ever fully offset, whether it is emergency spending for natural disasters or emergency spending for wars that have occurred in our history, but we have made those plans. That is what we intend to do now.

Let me direct you to a comment or a revelation that I have had that I am both surprised about, but I need some information on. That is, how is it that two-thirds of the money that has been dedicated to FEMA is sitting in their accounts? How long will that last? What is the spend-out rate, if you will? How long will this be enough to deal with the disaster itself?

There are some who are suggesting—and possibly appropriately so—that there are resources available in the FEMA accounts to meet the needs of some of the Federal reconstruction efforts that will be necessary and certainly very appropriate under the Stafford Act for rebuilding as a result of what has occurred. Do you have any information or would you like to comment on that?

That is the basic thrust of my questioning for today.

Mr. HOLTZ-EAKIN. The simple accounting of what has gone on is, of the \$60 billion that was appropriated, about \$14½ billion has been obligated, as of the latest data that we have, and that a little bit more has been allocated for obligation in the future. So a total of about \$18 billion has been allocated. Of that, \$8 billion has gone for housing purposes and about \$7 billion for relief and reimbursement of other agencies for relief purposes; and I think that is indicative of the kinds of things that one can expect.

We anticipate that, overall, about half of the moneys will be spent out over the course of fiscal year 2006. So for every dollar that goes into the Disaster Relief Fund, half comes out in 2006. That is a bit above the historic rate, but we anticipate that would be appropriate in this circumstance, and that past the first year you might get, with less certainty, say, 30 cents, and then the remainder would fall out in the years to follow. That is because the money applies to many different kinds of activities.

The direct assistance for housing families can get up to a bit above \$26,000 over 18 months. That might go out a bit faster, but it is still a spend-out over a year or more. That is very different than the money that will go for reconstruction of infrastructure, where it is not even feasible outside of those areas where they had to restore infrastructure just to get in for relief. In most cases, it is not feasible to even get in and assess damage at this point. It will take much longer to assess, identify what will be built, hire people, get the construction projects going.

It is a very slow process; and, for that reason, one should not expect those moneys to flow immediately out once they are put in the Disaster Relief Fund. They will be there. They will be available for a wide variety of needs. The money appropriated for Katrina was available for Rita, and it will be possible for the Congress to monitor the evolution of both the needs on one hand, as we find out more about the area, and the existing funding on the other hand.

If it turns out to be the case that the money flows out faster than these projections anticipate, the Congress has shown that it can come back and move quickly to provide more funds. But I think it is sensible to use the guide of history and the guide of the kinds

of activities to expect the money to go out over a fairly long period of time and to monitor it as a result.

Chairman NUSSLE. I appreciate the very strong interest in attendance of members today coming back before votes this evening, and I respect them and appreciate that. I will save any more questions I have for the end, and Mr. Spratt is recognized for any questions he has.

Mr. SPRATT. Thank you, Mr. Chairman.

Thank you, Director Holtz-Eakin, for your testimony.

Let me ask you, based upon what you know now and what you know about previous disasters of this kind, can you extrapolate or estimate what the likely cost to the Federal Government will be for the Katrina disaster, in particular?

Mr. HOLTZ-EAKIN. I think that is one of the two most dangerous questions you can ask me. No, I cannot give you a scientific answer yet about the scale of the damages; and it will be a policy call in the end as to what fraction of those damages that the Federal Government will choose to use its powers to pick up. That is the truthful answer.

What we know so far is that if one looks at other events—the three I have are 9/11, Northridge, and Hurricane Andrew: The damages for 9/11 were, rough estimates, \$87 billion; supplemental appropriations total were about \$35 billion. Damages in the Northridge earthquake were about \$50 billion; \$12 billion in supplemental appropriations. Damages for Hurricane Andrew, about \$40 billion; a little under \$6 billion were supplemental appropriations.

We have only guesstimates, as I said, about the damages in this particular event—combination of events, actually—\$70 billion to \$130 billion for capital losses, but there could be other costs like debris removal; and there is about \$62 billion in direct appropriations so far and some other legislation that is intended to provide help.

So on both sides of that ledger I can give you some information, but I cannot tell you where we will end up. One is in the hands of the damage assessment, the other is in the hands of the Congress and the administration.

Mr. SPRATT. We hear the number \$200 billion as a seat-of-the-pants estimate, and I think that \$200 billion means the total cost of Hurricane Katrina and not necessarily the Federal Government's share of that cost. That is the total that insurance companies must share and others. Do you have any light to shed upon that?

Mr. HOLTZ-EAKIN. We have tried to fairly carefully disentangle two kinds of losses. One kind of loss is just things that were in place and were damaged, buildings, and they are gone; and the second is losses of flows of income. Now they are not related obviously, but the wages that go away with the jobs and the profits that go away.

The insurance companies often insure both, both the structure and business interruption insurance, you lose some business income. The insurance company estimates of total losses run a bit higher as a result. We have seen \$140 billion as an estimate out of RMS, a risk management firm. There are some comparable estimates out of some of the other insurance groups.

So estimates that include sort of a broader scope of things are north of ours, but they are all south of \$200 billion, but all in the range of \$150 billion, say.

Mr. SPRATT. Which would mean that the Federal share is likely to be under \$150 billion itself then?

Mr. HOLTZ-EAKIN. Yes. Well, I mean, if the private insurance pays out part of that, the Federal share, what is over, over by definition, is well below that.

Mr. SPRATT. If we decided to have a 1 percent across-the-board cut in discretionary spending and backed out defense and homeland security, which I think would probably be the formulation most likely, how much would 1 percent shaved across the board in the domestic discretionary accounts produce?

Mr. HOLTZ-EAKIN. We can get you the exact number, but it has got to be on the order of \$4 billion.

Mr. SPRATT. About \$3 or \$4 billion. Not a great deal of money if you look at the magnitude of what we have got to do then.

Mr. HOLTZ-EAKIN. Small in comparison to these losses.

Mr. SPRATT. Back in August, when CBO came before us with its update of the budget and its update of the economy, we asked CBO to take that a step further and to adjust it for certain assumptions about likely actions by the Congress and by the administration. In particular, we asked you to assume that the tax cuts passed in 2001 and 2002 and 2003 for the most part would be extended when they expire—most of them in 2010, some before—and that other tax cuts on the administration agenda—at least its agenda—at least of its July update mid-session review—would also be enacted.

We asked you also to assume that the alternative tax will be fixed such that it didn't apply to more than the percentage, around 4 percent, of tax filers who now get affected by it. We asked you to take the President's budget, which applies the cost of Social Security privatization, partial privatization, in 2008 and 2009 and carry that out through 2015. And, finally, we asked you to plug into the forecast CBO's own model of what Iraq and Afghanistan are likely to cost, assuming a drawdown of troops after 2006 to a steady state of about 20,000 in each theater.

I have got an electronic chart here that shows the impact, my point being that we had a serious problem before Katrina. Katrina worsens it, but the heart of the problem was there before Katrina. Katrina's worsening of the problem is not exactly marginal, but the problem was already extremely serious before Katrina hit us.

Your estimate of deficit for this year was \$331 billion when we close the books on September 30. You assumed that this would decline to \$57 billion by the year 2015, but that rested on the various substantial assumptions that the tax cuts would not be renewed when they expired in 2010.

We have gone back, using your projections, added in the President's budget, per your estimates. When we do this, we see that the total changes—and this is basically your study—are dramatic. The deficit of \$331 billion per the assumptions that we used to adjust your forecast would grow to \$640 billion, would double. Debt service is not shown on there, but it would grow from \$182 billion this year to \$458 billion in 2015, almost triple. The national debt held by the public would increase from \$4.6 trillion to \$9.2 trillion.

Now those are the numbers before Katrina. What we have done since then is try to add to where you left off the likely cost of Katrina using, as I understand it, your spend-out ratio, your outlay ration. If you will just take a moment to look at that, can you tell us, does that look like it is in the ball park for what Katrina's likely input is to be? We have assumed \$200 billion total cost to the Federal Government, which is a substantial assumption. You can whittle that back \$50 billion and adjust the bottom line. But do those numbers like credible to you?

Mr. HOLTZ-EAKIN. Yeah. The only line that we have never really looked at is the one which is the additional to reach \$200 billion. But the spend-out rate on what we have got over the first couple of years is about right, and the large patch of zeros to the right I think is the key way to think about this. Most of what is true about the budget before Katrina will be true after, because these are, in a budgetary sense, transitory.

Mr. SPRATT. But at the end of the period, instead of a \$640 billion deficit, we have a \$655 billion deficit, still serious but still in the same ball park.

Mr. HOLTZ-EAKIN. Most of that is the debt service and will depend on how much is done, whether that \$200 billion target you chose is appropriate or not.

Mr. SPRATT. Thank you very much, sir.

Mr. RYUN. Mr. Chairman, thank you.

First of all, I want to compliment you on having this hearing and also your leadership. I appreciate your willingness to look for and lead us on fiscal responsibilities. I know that I can subscribe to the same thing you feel, a difficult decision put off today only makes it more difficult tomorrow. We are talking about our children, our grandchildren, and the future of this country. So I thank you for your time.

Mr. Director, my question relates to a call that I am sure that many of us have had in our offices. It relates to the cost of fuel in this country when we go to the gas pumps and pay a lot more than what we ever have before. As we look ahead to the winter heating oil, there is going to be a lot more expense involved in that. My question relates to what can we look at in terms of when this, the higher energy costs, might begin to change. And if you could respond in terms that the person on the street can understand, different indicators that if they see those changes coming, they might begin to feel some relief of some of these higher energy costs.

Mr. HOLTZ-EAKIN. I think the bills that people are paying attention to are their gasoline bill when they fill up at the pump; and there, you know, we are now running—instead of \$1.80 to \$2, we are running north of that, somewhere at \$2.75 or higher, depending on where you are. We anticipate that it will not go back entirely to the \$2 level. We are expecting the damages to refineries and the gulf production to have impacts that last through early next year.

So the first lesson is, not all of this goes away. Not all of it goes away quickly. But we expect a lot of it to dissipate over the next 3 months so that, beginning next year, the big bulk of the gasoline price impact has largely gone away. Not entirely. The heating oil is likely to be substantially higher. There has been a lot of atten-

tion paid to that. Most of the increase in heating oil is the derivative of the fact that oil is more expensive and most of that preceded Rita and Katrina. So that is true. One would not expect it to entirely reverse. The good news there, to the extent there is some, is that that is not the main source of winter heating in most of the country, it is a small fraction of heating.

The third big impact is electricity. Underneath that natural gas, where natural gas powers electricity and natural gas as a direct heating source, natural gas prices are expected to remain higher.

That I believe is the major energy event that has happened. Eighty percent of production of natural gas is domestic. It is very different than the large imports of oil, and we damaged a lot of our capacity to both produce and distribute it. So that is the bill to watch, and I think that will be the one that most people will notice as time goes on.

Mr. RYUN. So you are saying maybe by next spring we might see some relief, but there is never going to be a return to some of the lower prices we have become accustomed to.

Mr. HOLTZ-EAKIN. I think oil and gasoline next spring is on a path where we would go back to something that looks like pre-Katrina and Rita, maybe even lower for oil. For natural gas, I am far less confident in that.

Mr. RYUN. I have a second question. I want to tag team off of what Mr. Spratt had to say. I know we are all concerned about the cost of Katrina and Rita. While you at this point cannot be pinned down—I understand that to a certain extent—what I would like to have you do is respond to what you see as possibly a way to help control some of the costs by perhaps giving some incentives to the private sector, some things that might help control some of the costs. Because that is something that we are all concerned about. We want to be compassionate, but we also want to be responsible.

Mr. HOLTZ-EAKIN. I think there are two issues in controlling cost. The first is, for those events that have already transpired, Katrina and Rita, these are instances where one would like to rebuild at minimum cost, one would like to provide efficient financing, and to the extent that the standard mechanisms of bidding and oversight and good enforcement of contracts are brought to bear, that is the key. And that is very much what we would hope would be business as usual.

I have another question, whether going forward there could be incentives in insurance markets, making them function a little better so that people would not put themselves in a position to suffer such exposed losses from other disasters. And that is a set of questions that we try to address at the end of the testimony.

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

Thank you for being here today. Just a couple of comments and a question.

First of all, I think the discussion around family budgets is appropriate except that when families do sit around and create their budget they are trying to deal with what priorities their families have and their budgets reflect those priorities. And I think quite frankly the American public takes a look at the Federal budget and gets a very clear indication of where our priorities are and how it is that we would spend their dollars.

I would also add something to what Mr. Spratt said about the need for why are we offsetting the cost for Biloxi and not Baghdad, but in addition to that, other kinds of spending, ongoing military operations, Iraq, Afghanistan, the energy bill, the new tax cuts, none of which are offset. So that leads me then to my one or two questions.

The other piece is given the \$332 billion deficit, the third worst in American history, what sense does it make to increase the deficit by another \$34 billion for big tax cuts for people earning over \$200,000 a year? So does it make sense to consider freezing the estate tax at the current marginal rate and exemption level?

As I understand it from your June report on this issue, with a 46 percent tax rate and an exemption rate of \$2 million scheduled to take effect next year, only about 21,000 estates would have to file a return. But the revenue that would come to the treasury would still be more than \$105 billion over the next 5 years, about half of what may be needed to pay for the Katrina cleanup. In contrast, full repeal of the estate tax would in 2010 benefit exactly 384 families in Louisiana, Mississippi, and Alabama, and would cost the Treasury almost \$1 trillion in foregone revenue and interest on the debt. Which of those two options do you see having the greater public benefit?

Mr. HOLTZ-EAKIN. This is the central question about the appropriate scale of offsets and the composition and it is the one that I will carefully not answer. I will do my very best to provide some guidance in how one might think about this. There have been a variety of principles that one might toss out to guide the search for offsets. One might be a rule that simply says I am an old-fashioned deficit hawk and the net increase on the deficit should be zero, full offsets somehow.

Another principle that one might operate by and which I have heard people discuss is one that says, well, we should offset except for those things where the benefits do accrue somewhere down the line to our children. If there is a genuine infrastructure project that produces benefits over a long period, it might be appropriate to allow them to pick up a little bit of that but offset the rest.

The third possibility which I have heard is this is a temporary economic event that should be addressed with temporary economic policies so you do not change permanently policies such as an estate tax in response to a transitory economic event. That says debt finance everything.

That brings me to the second thing worth thinking about, which is that that kind of guidance assumes that the underlying budget starts from a position that on average balances and financing is put in place for the programs that the Government has undertaken, and that is not where we are. And so it may be the case that we will have to intermix the long-term process of getting the budget back into alignment with its objectives and the response to these transitory events.

That is as best as I can give you a set of guidelines of how you might think about it without actually answering the question.

Ms. DELAURO. Therefore, no answer to the question about another \$34 billion through tax cuts for people earning over \$200,000 a year. Does it make sense for us to go down that road?

Mr. HOLTZ-EAKIN. As you know that is a policy call and we seek to guide you with the numbers and their impacts and we hope it is useful.

Ms. DELAURO. Quick question. Ahead, fiscal year 2007, the purpose of this hearing, the administration's budget includes no funding for 2006 for Iraq, or Afghanistan. Have you calculated how much future war spending may occur? If so, how much in 2007, how much over the 10-year budget window?

Mr. HOLTZ-EAKIN. Again we do not know for sure. As Mr. Spratt mentioned, we have tried to gauge the rough magnitude of scenarios which involve a continuation of the current level of forces in Iraq and Afghanistan and the support troops in surrounding states and a ramping down due to the acknowledgment that keeping that scale there over the long term is simply not sustainable. That ramping comes down to about 50,000 troops somewhere abroad by 2010 and remains at that level for the remainder of the budget window. If one takes that scenario at face value, outlays would total about \$380 billion over the 2006–2015 period. So some number like that seems appropriate for a continued involvement in a war of this type somewhere over the long term.

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

Mr. CRENSHAW. Thank you, Mr. Chairman. Thank you for your testimony today. It seems to me that it has helped put our particular problem here in the Budget Committee more in perspective because while the hurricane devastated the region along the gulf coast, and being from Florida I can understand, we went through Hurricane Andrew, which up until this time was the largest natural disaster. And it certainly is awful and terrible as it relates to those localities and the local economies. But I guess you give us a ray of hope in the sense that because of the strength of our national economy, being the largest and strongest economy there is, \$13 trillion, that we can handle from an economic standpoint a situation like this. And that is I think relatively good news that we have not seen long-term treasuries spike up. Most of the economic indicators are kind of still on track. I think you said that maybe we will expect economic growth to slow down maybe a half of percent this year but kind of get back on track.

It has been pointed out that our public debt is going to go up obviously, but I read not long ago the Federal Reserve has said now we have about a \$50 trillion net worth in terms of our families and our economies. So \$4 trillion over \$50 trillion is a pretty good debt to equity ratio, that we are handling that pretty well. But I still think that we are all concerned about the deficit.

That is the one thing. The good news is the economy is strong and getting stronger, and it will have a little blip because of this. But still people are concerned about the deficit. And we cannot help but recognize that if we spend \$60 billion, which we have already done, and another \$60 billion or up to \$200 billion it will have an impact on the deficit.

I guess the good news there is, as the chairman pointed out, just this year that estimate was reduced \$90 billion. We are talking \$330 billion deficit, which is about 2½ percent of GDP, down from maybe 4 percent. So if you add another \$200 billion it maybe goes

back to up to 4 percent, but overall it is kind of well within the range.

My question is kind of theoretical. Because I know being from Florida when we went through this kind of terrible disaster the local economies suffered, particularly in south Florida with Andrew, but there was a tremendous windfall in terms of sales tax revenues as the economy came back and all the building took place. I am sure you can quantify that in the region along the gulf coast that they will go through that cycle.

My question is, is there any way that we can understand the investment that we will make at the Federal level, whether it is \$60 billion, \$100 billion, or \$200 billion that is pumped back into the economies and in particular those local economies? Is there any way to quantify what kind of return on investment we might receive as a nation? Is that something that you can help us with?

Mr. HOLTZ-EAKIN. If it is a theoretical question I can give you a theoretical answer, yes. Now, actually doing it turns out to be pretty hard. There have been a large number of studies that attempt to look at the rate of return on Federal spending for capital projects, and they run into a variety of—they do not always produce particularly cheerful results, but they run into a variety of obstacles in getting the rate of return right. No. 1, there are a lot of things put in place which are not intended to produce economic benefits. They are simply meant to make people's lives better, and quantifying the degree to which people's lives are better is pretty hard. So you do not get the answer right from doing that.

No. 2 is that there is a big difference between history and the future. The destruction that is evident from looking at the photographs suggests that the rate of return of putting some basic things in place down there is going to be very different than the same highway in some other location.

And that brings No. 3, which is, is it the case that we have always spent our Federal capital dollars wisely? Have we chosen things in an economically efficient fashion to put them to the best bang for their buck? Well, I think most of the studies would suggest no, and that is an ongoing issue.

Mr. CRENSHAW. But you would say, for instance, in terms of some people would argue that the economic growth that has taken place as the economy has recovered is due in part to letting people keep more of what they earn, cutting corporate taxes, business taxes, that kind of has a positive impact. So some would say that is theoretical. Some would say that is pretty practical.

Mr. HOLTZ-EAKIN. It is far from theoretical that the key question is what are the incentives for a robust growth for economic environment. I think that there are—this is an economy that relies on the private sector extensively for that and it requires a bit of support from the government sector. And one of those places is putting in place the basic foundation in terms of both legal institutions and contractual institutions but also physical infrastructure to do the work, and getting that right is a key part of the job.

Mr. CRENSHAW. So the good news is at least theoretically that some of the money that we are spending now to solve these problems, there will be some sort of return on the investment which might help our economy grow?

Mr. HOLTZ-EAKIN. Yes.

Mr. CRENSHAW. Thank you very much.

Chairman NUSSLE. Mr. Cooper.

Mr. COOPER. Thank you, Mr. Chairman. I want to first thank Douglas Holtz-Eakin for speaking to the Nashville Rotary Club. I am sorry I was not there to personally greet you but I appreciate you making the effort.

Mr. HOLTZ-EAKIN. I was there the day Katrina hit. I hope it was a coincidence.

Mr. COOPER. I think most Americans are getting more and more concerned about the deficit, and I think if there is a silver lining in the Hurricane Katrina it is that people are more sensitive to deficit issues than they were in the past. I think most Americans are looking for accurate information about the deficit, and I have run across a couple of things recently that I thought were interesting.

One is from the Cato Institute, October 2005. The headline is "Bush Beats Johnson," comparing the Presidents. It points out that President George W. Bush has expanded Federal nonentitlement programs in his first term almost twice as fast each year as Lyndon Johnson did during his entire presidency. So already President Bush is beating Johnson two to one and he still has most of his second term to go, so it could be a four to one margin.

The one area in which President Bush is not exceeding Johnson's spending levels is in entitlement spending. But of course the new Medicare drug bill has not kicked in yet and it will start kicking in on January 1. As Senate Budget Committee Chairman Judd Gregg says, that bill is \$43 billion over budget and it has not even started yet. Not a good omen.

That is at the macro level. At the micro level more and more of my constituents are sensitive to earmarking projects in the Federal highway bill recently passed. There is an interesting article in today's Roll Call newspaper that looks at the last 50 years of highway bills and it says this: "over the past 50 years there have been 9,242 earmarks in highway bills. Of these, 8,504, or 92 percent, have been inserted in the three highway bills enacted since Republicans took the House 10 years ago, 92 percent of all earmarks in the last half century just in the period in which our Republican friends took over the House of Representatives.

Now, there are some very worthy efforts going on across the aisle. The Republican Study Committee (RSC) has Operation Offset. We appreciate that. But for folks back home it is results that count. I am going to be appearing with Senator McCain tomorrow in an effort that I think was pioneered by Mr. Flake on your side of the aisle to delay the Medicare drug bill for at least 1 year in the hopes that at least some of it could be paid for.

I believe in Mr. Flake's estimate that alone would save about \$40 billion, and since it is so hard to get a handle on the cost of these entitlement programs and, as I said, according to Senator Gregg that program is already \$43 billion over budget when it has not even started yet, that would seem like a good area to begin looking for real savings. Because we all know that no matter how much you get highway earmarks cut or trimmed that is small potatoes in comparison to the numbers we are facing with Katrina or Iraq or other out of control areas of Federal spending.

So I thought it might be useful for the committee members and the public at large to look at some of these things. I think the average member of the Rotary Club back home would be startled to think that George W. Bush was twice as liberal as Lyndon Baines Johnson at least in terms of domestic discretionary spending, maybe twice as liberal in terms of entitlement spending. That is a hard thing for a lot of folks to grasp. At least if the Cato Institute is right and they seem to have a pretty sound analysis here, that is the way things are heading.

So to me it is not just a question of whether Harriet Miers is a conservative or not. It is becoming a question of whether this President is a conservative or not. Because, as you know, he is the first President since James Garfield in 1881 never to have vetoed a bill. He is the first President since John Quincy Adams to serve full terms never to have vetoed a bill. He is the first President since Richard Nixon to never have rescinded any spending. President Reagan rescinded 600-plus items. President Clinton rescinded over 163 items. But this President has rescinded zero items even though there are three congressional districts in the highway bill that got about \$2 billion in combined total. One congressional district alone got \$760 million in the highway bill. That is a Congress that is spendthrift and out of control. I thank the Chair. I see that my time has expired.

Chairman NUSSLE. Mr. Putnam.

Mr. PUTNAM. Mr. Chairman, I am sure it will be of great comfort to people of the gulf coast to have the tutorial on presidential veto history, but let me ask you a question, Mr. Director. At the macroeconomic level in your report you touched on the inflation effects and the employment effects of reconstruction. But what you did not touch on and I am curious, because anecdotally we are hearing an awful lot at home about inflationary and employment pressures, as we see what was already a shortage of building supplies in the country, with steadily increasing prices as a result of the fact that they are petrochemical in nature, asphalt, shingles, things of that sort, and increased international demand; in other words, all the cement and copper and rebar going to China.

Will this huge influx of construction needs in the gulf coast region put substantial inflationary pressures on the rest of the housing market, which has created I think half of our GDP growth in the last year, and what effect will it have on labor markets as skilled labor sees an opportunity and flocks to the gulf coast to be a part of the rebuilding efforts?

Mr. HOLTZ-EAKIN. The analysis is directly on the mark. We focused in our report on the broadest macroeconomic impacts, overall levels of consumer prices, overall levels of economic activity, touching only lightly on particular sectors. I do think we noted, at least I hope we have in this and in particular what we have in others, that the rebuilding effort will place particular pressures on the construction industry. I think the dynamics you described were exactly on the mark. One would expect the resources used intensively to become more valuable. You will see some pressure on prices there and you will see the skilled construction workers being in demand. I think that is exactly right, and it will in fact influence the pace

of the reconstruction in the gulf area and it will influence building elsewhere.

Mr. PUTNAM. Your report specifically says that by early next year the pace of reconstruction will probably cause the net effect of the hurricanes on jobs nationwide to be minimal. And the effects on inflation, you said higher prices for construction materials and higher energy prices through transportation costs will tend to temporarily increase growth in the prices of non-energy related goods as well as airline, bus, and rail, et cetera. You mention it but you make it sound like it is really not going to be that noticeable. And as somebody who had to wait 10 months to get a new roof after last year's hurricanes in Florida because of a shortage of materials and because these roofers have literally a 1-year waiting list—they have not caught up in Florida yet, and this is an exponentially larger event than what we had in Florida a year ago. Again, I am not taking issue with your numbers, but I have to believe it is more than a minimal or a temporary increase. I am curious to dig a little deeper with you on that.

Mr. HOLTZ-EAKIN. Sure. I think that you have said more clearly than we have the essence of the fact that these are bad for the economy. People's roofs are gone. The fact that there is money to be made putting them back on does not disguise the fact that people are worse off, and waiting 10 months for a roof is a bad thing. The essence of the numbers in the report is on average, across all States, across all industries, those doing better, those doing worse, what would be the national economic impacts and they are noticeable certainly in the next quarter or so, thereafter averaging out to be back to where we might have been otherwise and maybe a bit above. That does not disguise the fact that in some cases people will be demonstrably worse off, and there will be some long-term unemployment in the gulf coast from this. That will be an example. There will be people with long waits to get their work done. That is also true.

To the extent that we have underestimated that mix, that is one of the risks in what we have done. I would acknowledge at the outset that the balance of how quickly some of this rebuilding gets done versus some of the other adverse effects is a key part of the risks.

Mr. PUTNAM. Well, I agree that there is risk built into all of these models, but I am substantially more pessimistic than your report. I think we have already seen shortages of agricultural labor in California because of the movement of labor to the gulf coast regions who see opportunities in construction jobs. As I sit next to my friend from Mississippi, and I do not want to make it sound like I whine about waiting 10 months for a roof when these people do not even have a house, so you are faced with not one specialty in construction but entire new construction. With the inflationary pressures that means insurance dollars are not going to go as far. It means that everyone is going to see an increase in the price of goods, even housing markets in the Northeast or far West. And knowing what role housing has played in GDP growth, I think that is a real problem, but I appreciate your efforts.

Chairman NUSSLE. Mr. Case.

Mr. CASE. Thank you, Mr. Chairman. Sir, what has amazed me just listening to the discussion from a fiscal stewardship perspective with respect to Katrina and Rita as we have sat through the last couple of years watching, I think, the worst and I guess, more importantly, the most avoidable deterioration in our Federal fiscal condition, maybe in our history, we were not going through a world war. We were not going through a classic depression. We were going through some difficulties but not anything that amounted to the kind of deterioration in our kind of fiscal situation that happened in some of those other situations, and we went through a series of tax reductions which starved revenue, which did not generate the projected dynamic impact. We went through, as my colleague Mr. Cooper has stated, one of the fastest accelerations in domestic spending in recent history. We went through the difficult fiscal conditions of Iraq and Afghanistan, and it took us somehow Katrina and Rita to approach a serious discussion of the budget. That is amazing to me, and that is a prelude to my question.

Is there any fundamental difference between the budget balancing involved with Katrina and Rita versus the budget balancing that should have been involved with any of the other conditions that I have talked about over the last 4 years, whether it be Iraq, Afghanistan, whether it be an economy that did not come back faster than projected, whether it be the budgetary impacts of tax cuts? Is there anything fundamentally different going on here or did we just reach some point here when there seemed to be a critical mass of enough is enough? Are we in some different budgetary situation now just because of Katrina and Rita?

Mr. HOLTZ-EAKIN. There are things which are different and there are things that are the same. As I said to this committee before, I think if one looks backward from the vantage point of 2003 or 2004, whatever you pick as the right date, look back at the big swing in the budget from about 3 percent GDP surplus to a 3-percent GDP deficit, a 6-percentage point swing, dramatic in its economics, it is hard to make the case that this was economically damaging. I know there is the policy fight about whether it is the right composition. But at a time when the world economy was weak and there were a whole variety of domestic shocks from Sarbanes-Oxley to 9/11, you can go through the list, I think the broad consensus is that swing did not damage the economy. It may have supported it at a time when there was not a lot of spending from other sources.

That said, what is different now is that we are looking forward in a situation where we have a strong economy both in a cyclical sense, the impacts of the hurricanes notwithstanding in our view, and over the long term certainly, so that the budget is now being driven by policy decisions, and in that case I do think one thinks about it differently, the sustained large mismatch between spending and given the scale over decades, potentially worse. So that is different.

What is the same is if you are looking forward and you are looking at spending outside of the normal process for Iraq, Afghanistan, Katrina, and Rita, no, they are not different. The policy tradeoffs are required. The same economic issues are in play and they are balanced.

Mr. CASE. From a perspective of the offsets of our colleagues in the RSC, my understanding at least, is just another form of the PAYGO debate limited to the spending side. Would that be a fair characterization? We have had this debate over PAYGO for a long time now. I have not heard a whole bunch of disagreement with PAYGO as a principle. Where the disagreement is, is what is on the table when you talk PAYGO. The interpretation I have of the offset proposals is it is a spending only PAYGO. If you have got to increase spending because of Katrina and Rita, not because of Iraq and Afghanistan, not because of anything else, we are going to focus on Katrina and Rita, then we are going to offset that by spending in other areas. That is just another form of PAYGO. Would you agree with that?

Mr. HOLTZ-EAKIN. I will be honest I have not read the particular document that lots of people talk about, so I will not characterize it. That notion of a PAYGO rule is one of the principles I have heard people talk about without labeling it that way, to have a net zero impact on the deficit.

Mr. CASE. Again getting back to the question of the cost of Katrina and Rita, I accept and understand your answer that you cannot project certain things. You cannot project what Congress is going to do. You cannot project how much of the insurance proceeds are actually going to be paid. You cannot project how much Congress will choose to make up. But there are things that can be projected with the costs of Katrina and Rita. For example, you made projections about the impact on the economy. When you talk about the impact on the economy, you are talking about impact on Federal tax revenues given the current tax scheme. Have you calculated out the impacts that can be reasonably predicted within a range of assumptions on Federal tax revenue losses? I assume it is not just if any. There are going to be Federal tax revenue losses on the cost of funding outright Federal obligations which are in existence today. For example, the chart you had up there on FEMA obligations that are not dependent necessarily upon direct additional Federal appropriations, on increased calls from State and local governments for assistance with Medicaid and TANF and just right down the list. Has there been any projection on the costs that assume we met those obligations, we would in fact have a dollar amount that we could affix to it?

Mr. HOLTZ-EAKIN. Yes, in some fairly incomplete ways. Certainly the impacts of the hurricanes on the economy have feedbacks to the budget. So for example, our guess is growth lower by a half a percentage point in the second half of this year. That has revenue consequences that look to be something on the order of \$5 billion. Not a dramatic impact in a \$2.6 trillion budget, but it will have something to that effect. The damages also effect the ability to remit taxes so there has been some waivers and some money that would have come in this year that come in next year. There will be some things like that on both the tax side and on the spending side. Those turn out to be small compared to the other moneys that are at stake in the budget.

Medicaid would be \$1 to \$2 billion, say, for the 700,000 people that appear to be affected. The direct appropriations to the FEMA

Disaster Relief Fund are \$60 billion, \$30 billion of spending next year. Those are the magnitudes involved.

Mr. CASE. So just a final question, Mr. Chairman. If we talk about the range that has been tossed out there, whether it is accurate or not, of \$100 to \$200 billion total cost, would I be correct in saying that most of those moneys would be the result of direct actions by Congress over and above the consequential loss of revenues and the vast majority is the decisions that we are going to make, affirmative decisions we are going to make in terms of funding Katrina and Rita relief?

Mr. HOLTZ-EAKIN. Yes, those will dominate the budgetary impacts and play out over a number of years.

Mr. CASE. Thank you.

Chairman NUSSLE. Mr. Wicker.

Mr. WICKER. Thank you, Mr. Chairman. It is always good to see the chairman allowing a little leeway in time to the questioner right before me. I have a question but I cannot resist responding to a couple of the things my friends across the aisle have said. I disagree that the tax cuts have starved the Treasury and have not had a positive effect on economy and on revenue, and I think that the chairman mentioned that when the chairman mentioned revenue had actually increased and that he was touting that fact at the last hearing we had. Indeed, I think tax cuts are responsible in large measure for that.

My friend from Tennessee, Mr. Cooper, has had to leave the room. I will simply respond to what he had to say about the prescription drug benefit. I am almost certain the Democratic alternative to the Republican plan that was actually enacted was much more expensive than the law which we actually have in place. Similarly, I am impressed that there seems to be a willingness on the part of my colleague and friend to adopt some of the cuts that might be suggested by the very conservative Cato Institute. I would only hope that my friend from Tennessee can bring a few Democratic votes along.

Finally, with regard to the idea of delaying for 1 year the implementation of the full rollout of the prescription drug benefit, I will congratulate Mr. Cooper on that and say that if he can get up a substantial number of Democratic votes for that idea I would be happy to join him on the floor and call the question. I would suspect that any delay in the prescription drug benefit would have to be done almost entirely by Republicans, and upon doing that this seemingly deficient prescription drug benefit that we have passed would start sounding better and better since it would have been Republican votes that would have postponed it.

Nevertheless, I look forward to working with the gentleman.

But my question is about homeowners and business insurance, Dr. Holtz-Eakin, and the very, very real problem that we have on the gulf coast with property owners who had no flood insurance, who did not think they needed flood insurance because they were not in a flood plain. Many of them had their property mortgaged. Many mortgagees did not require flood insurance of these individuals. Many of them had hazard insurance. As a matter of fact, many of these property owners had all of the coverage that a reasonably prudent person relying on Federal FEMA maps could have

been expected to have under the circumstances, and yet they find that they are not covered because the damage is deemed to be flood coverage. In many cases that is subject to litigation but we know that in many cases that will be the case, Dr. Holtz-Eakin.

Now, there is legislation that has been sponsored by some members of this committee entitled the Hurricane Katrina and Hurricane Rita Flood Insurance Buy-In Act. Are you familiar at all with that, Dr. Holtz-Eakin?

Mr. HOLTZ-EAKIN. I am not familiar with the specifics of it.

Mr. WICKER. Let me tell you a little bit about the specifics. It would allow property owners affected by Hurricanes Katrina and Rita who did not live in places designated on the maps as flood plains but who did not have flood insurance, and who were then destroyed by water, to purchase coverage under the National Flood Insurance Program retroactively through the use of a buy-in. The property owner would be required to pay the equivalent of the national flood insurance premiums for 10 years with a 5 percent penalty, premiums to be set at a rate equal to the prevailing premium charged in the area. I can get you the details of that, but I think you get the gist of it.

What would be the implications for the Flood Insurance Program if the Congress were required to pay for losses incurred by people who did not have flood insurance?

On the other hand, what are the implications for the economy if these property owners are not in some way made whole for their losses? After all, they through no fault of their own relied on the Federal maps, had all the insurance that anyone could have been expected to have. What are the implications on the economy in general, on the banking and credit union industry, on property tax collections if we are not able to build those homes and businesses back, and what experience do we have based on other hurricanes that could be of benefit to us in trying to formulate some sort of fiscally responsible but fair and compassionate response to this terrible situation?

Mr. HOLTZ-EAKIN. Well, that is a good and very difficult question which I think probably we owe you a very careful answer for the record. Let me sketch briefly some of the issues that arise that we could flush out if you would like. The first is of course you ask what would be the consequences, and there would be budgetary consequences. I cannot do those in my head. We could try to work through that.

The second would be the implications on an ongoing basis for an insurance program when people are allowed to buy insurance after the fact. That is not a particularly great set of incentives from an insurance point of view. That would have detrimental impacts on overall functioning of an insurance program. We could work through the details of that.

Third is to recognize that insurance is not the only financial flow that can be used to allow people to recover from the loss of their home. There is self insurance which is saving; there is debt insurance; they can go borrow; and there are government loans. The Small Business Administration (SBA) provides loans to individuals as well as businesses. Those loans are subsidized by the taxpayers. And as usual when there are many policy instruments available,

it is a mistake to rely on one, in this case flood insurance, to solve all problems.

If this is an area where you would like a more detailed and careful answer we would be happy to work with you.

Mr. WICKER. Yes, as a matter of fact, I would appreciate that. I would simply say to you and members of the committee that I have my questions about the legislation that I mentioned to you, although it may be an approach that I might take a look at later on. But I am working with insurance, business, and governmental experts in my home State of Mississippi and in other locations to try to devise some sort of recourse for these property owners who are in my opinion blameless in terms of getting all the insurance that they could possibly get which they could reasonably be expected to get, and yet are just found in a devastating position having lost basically almost their entire nest egg.

So I would appreciate a comprehensive answer on the record and I will be happy to provide staff with your staff to work on this.

Mr. HOLTZ-EAKIN. Thank you very much.

[The information referred to follows:]

CBO RESPONSE TO CONGRESSMAN WICKER FOR THE RECORD

We can only guess at the Federal cost of the buy-in program. The amount of flood damage by hurricanes Katrina and Rita to structures that both lie outside FEMA's 100-year flood plains and were not covered by flood insurance is not known with any precision. A recent estimate of the total damage to the housing stock in Louisiana, Mississippi, and Alabama, both inside and outside of the 100-year flood plains, is more than \$40 billion, with \$17 billion of that damaged uninsured. Assuming that all of the uninsured loss was due to flooding and that the large majority was to homes outside the 100-year flood plains (because such homes greatly outnumber those in the flood plains and are less likely to have carried flood insurance), further assuming that the required payments (equivalent to 10 years of insurance premiums, scaled up by 5 percent) would total less than \$1 billion, and making some allowance for non-residential structures (which account for roughly 10 percent of flood coverage in force), the net cost of the buy-in proposal to the Federal budget would be in the range of \$10 billion to \$15 billion.

As noted in the testimony, the buy-in proposal would undermine the flood insurance program. It would encourage at least some current and potential policy-holders to forego flood coverage, on the expectation that the government would provide a similar buy-in opportunity in the event their homes or businesses were flooded in the future. That encouragement would be strongest for property owners outside the 100-year flood plains, who currently account for 30 percent of flood policies. However, those inside a flood plain also might forego coverage; some of them might simply be unaware that the program applies only to structures outside the flood plains, while others might anticipate that the eligibility requirements would be loosened in the future. Once the precedent for a post-event buy-in is established, one could argue for extending it on the grounds that the set of property owners who were not required to have flood insurance includes not just those outside the flood plains, but also those inside the flood plains who do not have federally-regulated or federally-backed mortgages. From there, one could argue further that it would be unjust to allow some neighbors to buy in after a disaster but exclude others simply because they had certain types of mortgages.

The buy-in proposal also would undermine market incentives for an efficient allocation of resources. In this case, efficiency requires that property owners fully recognize and be expected to pay an actuarially fair price for the risks they assume. But if people expect another buy-in proposal or a similar program that indemnifies property owners after a future flood, they will be more likely to continue living in flood-prone areas and to undertake fewer mitigation projects to reduce potential flood losses. Consequently, the proposal would encourage excessive (relative to the assumed risks) development in flood-prone areas along the Gulf Coast and nationwide and discourage worthwhile mitigation efforts, both of which would raise the damages and hence costs of future floods.

In the absence of any additional Federal aid for building repair and reconstruction, the \$17 billion of uninsured losses would be borne by property owners, lenders who hold the mortgages on those properties directly, investors who hold the mortgages indirectly in mortgage-backed securities, government entities that guarantee mortgage loans or mortgage-backed securities (FHA, VA, and Ginnie Mae), and taxpayers through existing aid programs. The share of the losses experienced by each group depends on a number of as yet unknown factors, such as the amount of homeowner equity in the affected properties; the amount of mortgages sold in secondary mortgage markets and not retained by lenders; and the number of homeowners who will file for bankruptcy as a result of their losses. The effects could be acute for some individual homeowners and their families, particularly those who had a substantial amount of equity in their homes. The effects of mortgage defaults on those properties are not likely to be significant for FDIC-insured institutions in the area because, taken together, they have enough capital to cover the losses, although some individual lenders may experience some difficulties. (The effects are negligible at the national level given that the amount of home mortgage loans owed by households nation-wide is almost \$8 trillion.) Fannie Mae believes that their share of the losses from Katrina and Rita will be between \$250 million and \$550 million, while Freddie Mac expects between \$150 million and \$300 million in losses.

As discussed in the testimony, the loss in the value of the housing stock would greatly reduce property tax revenues in the most heavily affected communities. To the extent that those communities remain viable places to live and work, that effect would diminish over time as new capital flows in to take advantage of attractive investment opportunities and the local population stabilizes and rebounds.

Chairman NUSSLE. Thank you. Ms. Capps.

Mrs. CAPPS. Thank you, Mr. Chairman. And Director Holtz-Eakin, thank you for spending time with us this afternoon on this topic. After the hurricanes, and interestingly following the last discussion, many of my colleagues are focusing now on our record high deficit. That is on target for me even though in fact in the long run Katrina's recovery costs are not really a huge factor in our deficits. But as Mr. Spratt has pointed out, the deficit has been a major problem over a number of years. And now we have many of my constituents, at least, who are saying as they watch us appropriately, appropriately, \$60-plus billion for Katrina efforts, wait a minute. They are saying, look at the war costs. Now it is Katrina. And our deficit. What gives?

So President Bush rushes to ask Congress to balance additional hurricane relief and reconstruction spending with substantial cuts to both discretionary and nondiscretionary programs, and ironically those cuts we would be making are to the very programs needed by the victims, many of them.

As we all know, Hurricane Katrina has created a health-care crisis for almost all of its victims, capacity crisis for many health-care providers, and serious fiscal problems both for the States directly affected and those hosting large numbers of displaced people. I believe that Medicaid is the appropriate vehicle to provide essential health-care services to low income Katrina survivors over the next month.

My question to you is what is your estimate, Mr. Holtz-Eakin, of how many people are now newly eligible for Medicaid given their change in circumstances post Katrina? That is, now will we see large numbers and can you help us with what the number might be, under current eligibility rules, because of their loss of income or other change of status?

Mr. HOLTZ-EAKIN. I can check and get the exact number. I think the ballpark is about 700,000.

Mrs. CAPPS. About 700,000 new individual enrollees under the current regulations for Medicaid.

Another question, as you know, Senators Grassley and Baucus have proposed legislation to provide immediate access to Medicaid for displaced individuals. That would be an appropriate response on the minds of many people that we would want to make it easier and faster for people to get relief in enrollment. And they also are wanting to shift some of the burden to the Federal Government. So far the leadership in the House has not wished to see this legislation brought up here, but I am wanting to know because it is certainly gaining interest by the public. Allowing this in many of our States, how many additional low income Katrina survivors would enroll in Medicaid under the Grassley-Baucus legislation?

Mr. HOLTZ-EAKIN. I actually do not know the number of enrollees, but we would be happy to get that back to you.

Mrs. CAPPS. But it would clearly be more than the 700,000 that you indicate?

Mr. HOLTZ-EAKIN. I know that the dollars involved in the net effect of that legislation are much larger than the ongoing cost of new enrollees under current law. Details beyond that I will be happy to get back to you.

Mrs. CAPPS. It seems to me with the hundreds of thousands of people now newly in need through no fault of their own, it is quite a strange time that we would be considering cutting a program like Medicaid, the very program which many of them, some of whom are constituents of our colleagues here, would be turning to in this time of need. I think that is the time this safety net would need to be strengthened rather than dismantled.

Now maybe in the time remaining, it is hard to pin these issues down, but if we were to cut Medicaid by \$10 billion, which is the minimum proposed I believe, it was desired to be more than that, but if we were to cut it by \$10 billion over 10 years and then we added these additional enrollees, could you describe that kind of scenario for us?

Mr. HOLTZ-EAKIN. I probably will fail you again on that but the staff has helped me with your question about the Grassley-Baucus legislation. That legislation, in addition to the baseline coverage, would bring 250,000 new enrollees into the program.

Mrs. CAPPS. So we are getting all these new enrollees at a time when we are expected, this committee has asked our Congress, to cut at least \$10 billion from Medicaid over 10 years. I just find that kind of amazing. Thank you.

Chairman NUSSLE. Mr. Chocola.

Mr. CHOCOLA. Thank you, Mr. Chairman. Mr. Holtz-Eakin, thank you for being here today. Mr. Chairman, I would like to thank you for, as you stated, sticking your head out of the foxhole and offering some constructive options to increase our fiscal responsibility.

I would also like to thank you for making the statement that it is time that we have a rainy day fund, to try to preplan for emergencies. And Mr. Holtz-Eakin, I think you said in your opening comments that families hopefully budget for emergencies. I think I would like you to expand on this, your thoughts on the Federal Government's prudence of budgeting for emergencies in the annual budget process and the economic impact that might have.

Mr. HOLTZ-EAKIN. The Federal Government does minimal amounts in the current budget process. There are some appropriations to the FEMA disaster account each year, small in nature. And my suggestion was that one could think of an insurance premium as being the average cost of the kinds of payouts that occur, and if one translated that to the Federal budget one could put into the budget a number each year which was typical of the cost over recent history, pick a horizon for the cost of disasters as appropriately designed, and count on the possibility that that would happen on average and have it compete with other budget priorities. That would be one approach to doing it.

What would happen as a result is that in some situations the costs would come in below that. And in that case, absent some other change in the budget, this would result in a net national saving, and that would be available to the economy, which is the ultimate resource out of which all of this would be paid, and it would make the savings, annual accumulation a bit larger.

In the years where the reverse happened, you would draw down on that, but it would be a way to allow for policy trade-offs between disaster and non-disaster spending and within disasters at different points of time, and then also provide the economy with the resources to ultimately come up with the costs of those disasters.

Mr. CHOCOLA. I take it you think it would be a prudent thing for us to do.

Mr. HOLTZ-EAKIN. It strikes me as a sensible way to go forward.

Mr. CHOCOLA. In that same vein, I represent part of Elkhart County, IN, which is the manufactured housing capital of the country. There has been a lot of talk about temporary housing needs, FEMA-related spending. And I do not know if this is in your jurisdiction, but the concept of having contingency contracts, using temporary housing as an example, in place prior to disasters, whether it be temporary housing or some other item that we know we are going to need to respond in an efficient and effective manner in emergencies. Would that be a prudent thing to do as well as have contingency contracts in place that we could act upon by having the logistics, the pricing and everything ready to go when we need it?

Mr. HOLTZ-EAKIN. That is quite frankly beyond my area of expertise. It is one of those issues that is on the list of using the dollars effectively. Putting the dollars in place is only the first step. Using them effectively in the sense of providing the basic needs quickly and providing them in a cost efficient fashion, those are important issues, and it is where the oversight of the Congress I think is central. But it is not a place where I can give you particular insight into that aspect to it.

Mr. CHOCOLA. Could you maybe give us a little bit of historical perspective as to the governmental role and the private sector role? You were talking about replacement investment in the first slide you showed us. Is that private sector investment or is that a combination of private and public?

Mr. HOLTZ-EAKIN. It would be both. The large Government spending that is likely to take place will be the big infrastructure projects, highways and buildings, of those things, and those largely will happen later. So the bulk of this and those which will happen quickest will be rebuilding in the housing sector. Home building,

commercial structures being repaired or rebuilt, replacing the equipment damaged within a business, that is going to be the key especially quickly.

Mr. CHOCOLA. Is there a way to characterize in 30 seconds or less kind of who does what, what you would expect based on a historical basis the primary role of the private sector and Government in this rebuilding effort?

Mr. HOLTZ-EAKIN. It is the case that there are different roles for writing the checks. Ultimately there is typically the hiring of the private sector to execute the projects. In terms of writing checks on the bulk of this, the damage will be in the private sector and the bulk of it will in fact take place in the private sector.

Chairman NUSSLE. Mr. Davis.

Mr. DAVIS. Thank you, Mr. Chairman. Mr. Holtz-Eakin, I apologize for being here and prolonging you for few more minutes. I will try not to take the full 5 minutes.

The only person I think that has testified before this committee more than you in the last several years is Chairman Greenspan. And one of the constant points that he makes when he talks with us about fiscal responsibility is the need to couple cuts in discretionary spending with changes in the revenue side, better known as tax increases. And I think he said several times before this committee that he thinks any kind of a real strategy of addressing the deficit long term has to include the revenue side. Is Chairman Greenspan wrong?

Mr. HOLTZ-EAKIN. I cannot imagine a question I am more afraid of. If the Chairman is wrong, A, I would not know. And B, we might say things differently but I think the straightforward public finance question is what programs will the Government have and how large will they be and over the long term then put in place a revenue system to finance them.

Mr. DAVIS. The reason I ask that is not to get a theoretical answer. The debate the committee is obviously having, we have a portion of the committee that has the mindset that we absolutely cannot touch any of the President's tax cuts. There is a portion of the committee that I think almost has the belief that you somehow violate his theological doctrine if you do that, that the tax cuts have to be kept in place, are presumed to preserve the health of the economy.

That interestingly does not seem to be the opinion of the person who is usually regarded as the principal expert on macroeconomics in this country right now. So I want to give you a chance to react to that.

Let me ask you a related question. In the early 1990s President Clinton and Congress raised the marginal tax rates and there was a lot of concern that that would damage the economy, that it would move us into a recession. In fact, Mr. Gingrich predicted that. Do you have any reason to think that the structural health of the economy today is somehow less than it was in 1992?

Mr. HOLTZ-EAKIN. The structural health of the economy is ultimately measured by the rate of productivity growth.

Mr. DAVIS. Is it less than it was in 1992?

Mr. HOLTZ-EAKIN. It is in fact faster than it was in 1992.

Mr. DAVIS. So therefore a better position to resist any change in the marginal rates?

Mr. HOLTZ-EAKIN. It is the result of not just market rates but all aspects of policy making. It has certainly been growing robustly since 1995 and has survived the most recent downturn.

Mr. DAVIS. And my response to that is that I suspect you are right. And I think that is something this committee should be thankful for. If it is our mindset that we are going to have deficit reduction strategy, then I think it has to include the revenue side as well. The only reason to not do that in my opinion would be if we felt that it would somehow do violence to the economy. Again, some of us in this town still believe that evidence is every now and then relevant to the argument.

So if we believe the economy is structurally stronger today than it was in 1992, in fact, in your phrase, if it is considerably structurally stronger, that suggests to me that we are even better positioned to absorb a marginal change.

The other point I would make is probably consistent with what Ms. Capps said. On one hand there is this notion that it is courageous somehow to have a 2 percent discretionary spending cut and that we are somehow asking everyone to share equally in the sacrifice. That strikes me frankly as a very curious proposition. Because if we performed a 2 percent discretionary cut not only would it damage the Medicaid program that Ms. Capps talked about, it would also damage the section 8 program that is being stretched even further because of Katrina. It would also damage the Head Start program and a variety of things that some of us think are still important to a class of underprivileged people in this country. I am having a hard time grasping the equity of imposing cuts on people in groups least positioned to bear those cuts.

In my final 40 seconds I would simply make the observation and ask you to takes it to the administration. I do not think it is the tough minded, principled, responsible thing for Congress to hide behind a veil of let us just cut everything across the board. I think we ought to be straightforward and make choices. I think we ought to say to the American people that we think that program is more important than that program. Those decisions ought to happen, sir, by doing it in a blunt draconian way.

And the final point I would make as it relates to equity, I think it is very hard to say to many of the people in this country that you are going to share in the burden of sacrifice, the people on Medicaid, the people on section 8, the people on Head Start, but we are not going to in any way allow people who have received the tax cuts to share in that burden. I think there is something fundamentally wrong with that, and I think it violates every notion of equity that I know.

Mr. WICKER [presiding]. Mr. Simpson.

Mr. SIMPSON. Thank you, Mr. Chairman. Let me ask you first, you mentioned in your testimony that the allocation for the funds for Hurricane Katrina could be used for Hurricane Rita. Is that across the board of the \$62.5 billion that we have appropriated?

Mr. HOLTZ-EAKIN. No, but the bulk, \$60 billion, were appropriations to FEMA. It is in the Disaster Relief Fund and it is available for the use of Katrina as well as Rita.

Mr. SIMPSON. The Army Corps of Engineers told me they did not have the ability to transfer some of their funds over to use in Rita.

Mr. HOLTZ-EAKIN. That is correct. There are small pieces of appropriation as well for the Army Corps and for Department of Defense (DOD). There is less flexibility with those.

Mr. SIMPSON. I happen to agree with Mr. Davis on one thing and that is that I do not like across the board reductions in spending. I think we should go in and make decisions. If we were to propose to the Appropriations Committee the various allocations for the Appropriations Committee that they had to go in and reduce them by 2 percent, I think the Committee on Appropriations could do that and make some priorities, and some programs might be cut more than 2 percent and some might be less than 2 percent, but we would be making decisions based on the program and the need; and as you said when you are looking at these things about how you are going to affect the future, rather than just looking at a 2 percent across the board reduction—and I could support some reductions in spending, but if you look at it, if we spend \$62 billion already on these hurricanes, and our total discretionary spending is somewhere in the neighborhood of \$880 billion. So if we tried to offset this whole thing through spending reductions, and you took in all the discretionary spending, you are talking about a 7, 7.2 percent of your total discretionary spending.

If you limit it to just non-defense, non-homeland security, you are talking upwards of 15 percent of your discretionary spending, if you try to reduce spending that much to offset it. Obviously, we are not going to do that. Unless we get into the mandatory spending programs, how are we going to balance this budget or get it back on track? And some people have suggested, as I think Ms. Capps was suggesting, that we do not do reconciliation. As you know, we are required to make some savings in various mandatory programs in reconciliation. If we do not do that, what will be the impact on the budget?

Mr. HOLTZ-EAKIN. The budget resolution calls for reconciliation savings of \$35 billion over 5 years in the mandatory programs. The mandatory programs are two-thirds of Federal spending. And as a fraction of mandatory spending, that is not a large number.

Mr. SIMPSON. If we talk about getting the numbers that Mr. Spratt had up there about the budget in the future, if we talk about getting that back in balance, we are necessarily talking about addressing some of the mandatory programs, and the further we put that off is that going to hurt our economy or help our economy?

Mr. HOLTZ-EAKIN. It is absolutely essential over the long term to address the mandatory programs, Social Security, Medicare, and Medicaid. Under current law with current spending trends grow dramatically. They are over 50 percent of Federal spending by 2015, and they become larger thereafter. And so it is, as a matter of arithmetic, unmistakable that this is the place that must be addressed in thinking about the long-term structure of the Federal budget. In the absence of changing any of those spending programs, the U.S. budget would grow increasingly out of balance.

It would not in, I think, anyone's view be sensible or feasible to continue to borrow ever increasing fractions of our national income

on international markets. The cost will go up or simply become impossible to acquire. So that means that you will either suffer some sort of mechanical debt crisis or you will raise taxes to levels that are much, much higher than they are today. That is the auto-pilot view of the fiscal future.

Mr. SIMPSON. One other thing that I wanted to mention. Everybody here has mentioned how their constituents are concerned about the budget deficit, just like mine are and I think just like all Americans are. But I can tell you one thing they have talked to me about more than anything, and I think this is a policy question that is probably not in your purview and you probably do not want to respond to it. But people are concerned more about how we are going to spend this \$63 billion or the potential for \$100 billion or \$150 billion in this hurricane related area, particularly New Orleans and stuff. If we are going to rebuild this in the same area that is so susceptible to damage in the future or if we are going to be smarter in how we spend this, and that we are rushing out to spend this money to help these hurricane victims before really sitting down and thinking about what we will do in the future.

I appreciate the fact that in your report you put in some language about things that we ought to be looking at maybe in the future about mitigation and how we stop subsidizing the cost of insurance in some of the areas, how we stop—I think one of them was that the Federal tax law discourages private provisions of disaster insurance by not allowing the accumulation of reserves in advance of catastrophic events, and so forth and so on. To me the disasters happen and we have to take care of it, but I think it is almost as important, if not more important, that we look at how we spend this money and how it affects what we are going to do in the future in this area.

I appreciate that. Thank you very much.

Mr. WICKER. Mr. Jefferson, do you have questions? You reappeared and surprised me.

Mr. JEFFERSON. I have lots of questions. Unfortunately I do not have time to ask them all. I was here to hear the testimony at the beginning of the hearing. But I had a Corps of Engineers meeting about levies in my area so I had to step out for a while. So I had to go take care of it.

I do not know how much Mr. Spratt had a chance to follow up and it is very dangerous coming in not having had the benefit of everyone else's question, trying to ask one. But he asked a question starting out that I thought was very important in his opening statement. It was about why we are, I know it is large, I know it is a big ticket, but we are dealing with the issue of paying for the Katrina disaster relief as against what we have done with the other disasters.

You take them all together, I am confident that they account for more money than we can ever contemplate spending in the Katrina instance. Yet before we can talk about that amount, we are trying to figure out how we can take it from some other places. No one wants to spread the disaster around to other people, particularly those who need help from the government the most, which I think is the essence of what his remarks were. I do not know how it got answered but why is it different in this case? Why are we seeking

offsets for the Katrina disaster relief? And why is it different from the other cases? And do not tell me it is larger than them. I know that. But to take them all together, it is not larger than everything else we have paid for around here.

Mr. HOLTZ-EAKIN. I am sure I do not have a complete answer to that, but from the perspective of they are independent of the policy, No. 1, this is not different than other disasters. One of the points of the testimony was to emphasize that while the scale and physical spread of the destruction was quite extraordinary, disasters do happen and in that respect this is not different and one might want to think about regular procedures that applied equally across all such occasions.

No. 2 was that at least what came up in the discussion was the setting may be different as opposed to the event. And we are starting from a position where the Federal budget is a pressing concern. It is not going to improve as a matter of economic growth. We are not going to grow our way out of the mismatch between spending and receipts. So the policies will have to come into play. This becomes a policy issue.

Mr. JEFFERSON. Yes. So if this has been true, as Mr. Spratt also pointed out, perhaps he has got all of the answers on this side.

There were already budget issues, have been budget issues around this place for a good long time. And as we have tried to deal with budget deficits and still deal with the Iraq situation and other emergency expenditures, we have not required payment for these offsets for these costs up front. There have been budget crises here for a good number of years now. So this is not a new circumstance. It may deepen it, but it isn't new. I think that there has to be some consistency to this policy, and we have got to have good reasons why it is not happening if we are going to accept it.

Do you think it is good policy to pay for these—if we are going to have to pay for these Katrina disaster relief—from the most vulnerable of the population of this country, people who we have already cut the Medicaid program tremendously in my part of the world?

As you point out in your statement, Louisiana does not have a tax base, at least the city of New Orleans doesn't have one at all. Our school board doesn't have one. New Orleans is about 36 percent of the tax base of the State of Louisiana, so it is suffering a great deal. And its citizens are spread out all over the place, everywhere. And we are talking about Medicaid cuts at a time when there are more people eligible for Medicaid than ever before now, because of this disaster.

Is that a smart policy?

Mr. HOLTZ-EAKIN. In the end, what becomes an appropriate policy will lie in the hands of the Congress. The question is whether the policy should be targeted uniquely on the costs associated with Katrina or whether you want to spread them more broadly to the issues facing the entire Federal budget.

The compositional issues will be a matter that are the priorities of the Congress.

Mr. JEFFERSON. People like yourself who count and report on the money and project about events that happen, you can project here that if you do not take care of people who—not just have the folks

who used to be on Medicaid before, but a new population of folks on Medicaid—you can calculate that if you cut Medicaid more, with a growing population, that you are going to have more people out there suffering.

And so my question isn't whether the policy you choose, or whether if you are sitting trying to figure out what is the best way to avert economic disasters from people around the country—is it a good policy to avert economic disaster for families that are going to be suffering from new circumstances they were not suffering from before?

There are people out there now who have been eligible for these programs and never would have been eligible ever in their lives before. But they are now, and they will be for some time.

Mr. HOLTZ-EAKIN. Indeed, part of the discussion that you were unable to hear is that there are about 700,000 people who will be newly eligible for Medicaid, for example, as it stands under current law. The costs to the Federal Government of providing Medicaid to those individuals will be a bit above \$1 billion, between \$1 and \$2 billion. And there exists under current law FEMA authority to provide housing and assistance, up to \$26,200 over 18 months, to individuals and families. So that there are indeed current authorities and moneys to provide some help to these families.

The question that will arise and which is at the heart of your line of inquiry is whether that is sufficient. And that is something that I think we will find as the months go forward.

Mr. WICKER [presiding]. Mr. Ryan from Wisconsin.

Mr. RYAN. I want to comment on the chairman's opening statement which I have read a summary of, which I want to just show strong support for his notion and his idea of amending the budget resolution to come up with the savings from spending control to pay for those large unforeseen expenditures. And that is what we are going to be debating here.

First of all, we have heard some encouraging support for this idea from the other side of the aisle. We heard some of it right here for addressing this through spending control. But we have heard probably a larger volume of ideas saying instead of engaging in spending control, in accelerating the spending control we have in the budget resolution, do not even engage in the spending control that we have already in the budget resolution, but undo tax cuts, or, more honestly, just raise taxes.

Now, I wanted to ask you, Mr. Holtz-Eakin, about the tax increases—or the tax cuts that we had in 2003. Do you have a list or an estimate of what we thought the tax cuts would cost when we passed them in 2003 versus the reality of the revenue receipts that we have now seen since those tax cuts were enacted?

Mr. HOLTZ-EAKIN. We know that the Joint Committee estimated at the time that over the roughly 2003 to 2008 window, this was a budget impact of about \$340 billion. And there has not been—and it would not be analytically possible to go back and disentangle from all of the other economic and budget impacts, how much we can trace to that particular piece of legislation.

But, you know, we had an initial estimate. We have seen the economy grow and have a strong cyclical recovery since. And we lie

in a position where indeed we have seen all of the cyclical improvement, by and large, one could reasonably expect.

Mr. RYAN. The reason I ask this question is because some are saying that the economy may be strong enough to absorb another tax increase. I hope the economy is strong, but I wouldn't want to risk that this economy could handle a tax increase at a time when we are coming off of these disasters, when we are experiencing a spike in energy prices, where we do have some inflationary signs on the horizon that Mr. Greenspan has pointed to, where we are going into a winter where we are going to see large natural gas price increases, we see gasoline price increases, home heating oil price increases, things that are very tough shocks to our economy. I think the last thing our economy needs right now is a tax increase.

I also serve on the Ways and Means Committee which wrote that tax bill, and I have the 2003 Joint Committee on Taxation release, which you used the Joint Tax estimates when you incorporated the estimate of tax revenue effects of tax policies.

The Joint Tax in 2003 when we passed that tax cut, it estimated that the individual income tax rate cuts would cost \$46 billion this year. They also estimated that the corporate, the business tax cuts that were enacted, would cost \$32 billion this year. Yet what we now find from reality is that over the last quarter, individual income tax receipts are up 16 percent, corporate income tax receipts are up 41 percent.

And so we are seeing that what we estimated then were going to be huge revenue losers, big costers, have in fact been the opposite. And that is largely because of the economic growth that has occurred because of these tax changes. So when we thought that reducing individual income tax rates would cost us \$46 billion in 2005, and reducing tax on capital and corporations would cost us \$32 billion, using the Joint Tax spreadsheet in 2005, we have already seen just this year alone, that in fact is not only not true, it is vastly untrue.

If you take a look at last year's numbers, they thought the individual tax rates would cost us \$88 billion. They thought the corporate tax receipts would cost us over \$50 billion. That did not materialize. Revenues were up; income tax receipt revenues, corporate tax receipt revenues.

So the point I am trying to make here is, I think what the other side is arguing for is tax increases to raise revenue, when in fact the tax increases they are calling for never cost the revenue that we thought it would cost when we passed those tax cuts back in 2003.

So I think it is important to look at reality, actual performance, what actually happened to the Government through receipts, what actually happened in the economy as we go forward and make policy with respect to paying for Katrina.

The one thing we do know for certain is that if we do enact an across-the-board 2 percent cut in discretionary spending, if we increase—and it is less projectable—increase our mandatory savings, we will save that money; and we can easily project 2 percent across the board will save us about \$20 billion. Is that not correct?

Mr. HOLTZ-EAKIN. Yeah.

Mr. RYAN. So we know we can come up with the savings through spending control.

People on the other side have said we have spent too much money. I agree with that. That is where I think we ought to place our emphasis, in making sure that we pay for this disaster and not increase taxes because, No. 1, it is bad for the economy; but, No. 2, it defies the logic, given the fact that we have the reality in front of us, because these revenue cuts, these tax cuts, have actually increased revenues. Thank you.

Mr. WICKER. Dr. Holtz-Eakin, I just have a few more questions I do not think will take long. On page 7 of your prepared testimony, you say that Louisiana is expected to face the most severe revenue problems from all of those affected by the hurricanes.

Early information from Mississippi, Alabama, and Texas indicates that the State general fund revenues may not suffer significantly as a result of this storm. I really wonder what you are basing that on and how you can say that, particularly in light of the fact that you say the data from the State of Louisiana have been hard to acquire.

The information that I received from the Governor's office, after I read this testimony today, was that out of a projected budget of \$4 billion for my relatively small State of Mississippi, revenue losses may amount to \$400 million.

Now, later on in your testimony, you say that perhaps out of projected revenue of \$12 billion in Louisiana, the lost revenues might be \$1 billion to \$3 billion. Well, if it is nearer to the lower amount, then you would have to agree that that would be about the same percentage of revenue lost as we are expecting in Mississippi. Am I correct on that?

Mr. HOLTZ-EAKIN. First, on the general issue of the quality of these numbers, I want to emphasize that it was our hope to identify the income losses in both the public sector and the private sector, but to get some sense of this for the States as well as the localities. But these numbers are extremely difficult to pin down. And I won't pretend that they have any undue precision.

In the case of Mississippi, we relied not exclusively, but to some extent on the testimony of a State revenue officer in front of the Mississippi legislature. And it was that testimony that provided some official sanction to ballpark estimates.

Mr. WICKER. Do you recall the figure that he gave?

Mr. HOLTZ-EAKIN. I believe it was a loss of less than 5 percent of Mississippi State revenues, something that one does not want to pretend is nonexistent, and certainly given the timing, introduces cash flow issues, but which in a sense of trying to get a magnitude, we felt would be useful for people to know. This is one area where we will learn a lot more as we go forward. I would really emphasize that as opposed to what we know now.

Mr. WICKER. Well, I would simply caution you on making a statement such as that based on incomplete data irrespective of the fact that you do base it on some testimony. I do expect it to be larger than 5 percent revenue loss and will be delighted if I am wrong on that.

The only other thing I want to ask about, Mr. Ryan from Kansas asked about gasoline prices and about the oil and gas industry.

Let me just ask on page 3 of your testimony you mentioned platforms and pipelines being damaged, particularly one large platform, the Mars facility, which on its own accounts for 10 percent of the gulf oil production and was damaged badly enough to be out of service, early 2006.

In all of this, do you have any information about environmental losses or damage as a result of damage to these platforms or pipelines? Have there been any significant spills that you have learned about because of this double lick that oil and gas platforms have had in the Gulf of Mexico?

Mr. HOLTZ-EAKIN. It has been a concern. It has been expressed in a lot of circles. But we have no firm evidence on that. And I know that it has been raised not just in the gulf but also in various areas for rebuilding. We are looking forward to finding out more as time goes on.

Mr. WICKER. If you have no information so far after 5 weeks, would it be fair to begin to feel that there in fact have been no spills resulting from these two catastrophic hurricanes in the Gulf of Mexico?

Mr. HOLTZ-EAKIN. I would hesitate to draw these conclusions. There are an enormous number of damages that we know are likely to have occurred that we have not been able to assess as a Nation. And certainly the CBO relies heavily on other people's efforts to gather information.

Mr. WICKER. When you get anything on that, again I would appreciate you getting it to me.

And lastly with regard to your statement that offshore facilities may be able to resume operations in the next few weeks. If they can, oil, natural gas production from the Gulf of Mexico may average half its normal level for the rest of the year.

And, of course, based—I guess it was based on that information, in part, that you answered Mr. Ryan from Kansas' question, about next year's gasoline prices coming back to a pre-Katrina level. Am I correct that it is based on that fact that you made such a guess-timate for us?

Mr. HOLTZ-EAKIN. The gasoline prices are driven in part by how fast crude oil production resumes in the gulf, but much more heavily by the restoration of refinery capacity and full functioning of the pipeline system.

Gulf production is 2 percent of the world crude oil market. It is a world market. The particular blending of gasolines for regions for air quality considerations means that there are much tighter supplies of refinery capacity. That is the crucial element in the pace at which gasoline prices might return to pre-Katrina levels.

Mr. WICKER. And all of the data that you have obtained with regard to gasoline availability and pricing, have you seen any evidence of price gouging on the part of this industry?

Mr. HOLTZ-EAKIN. It is not something that we have the data to comment on in any meaningful way.

Mr. WICKER. Thank you very much. Mr. Jefferson.

Mr. JEFFERSON. I just have one or two. I hope we get the numbers right for Louisiana and Mississippi. And so I do not want to fuss about our problem being larger than yours. They are big enough.

But I do want to ask a question about if we just consider the economic effect of actions taken here, is there any specific kind of spending in response to a disaster that has more of an advantageous effect on the economy than another; for example, for infrastructure, as a gauge to payments to individuals?

And there is a lot of talk here still about making the tax cuts permanent on dividends and capital gains. Will any of that sort of extension help the hurricane survivors? Can you answer that?

Mr. HOLTZ-EAKIN. On the economic impacts of different kinds of spending in the affected areas, infrastructure versus payments to individuals for housing or Medicaid, health, things like that, I think it is best to think of those as differences in timing.

There are, you know—the provision of FEMA relief is intended to provide for basic needs in the aftermath of such a disaster. That has clear economic benefits where the goal of any economic activity is to make people better off. So that is the immediate needs. That is what that provides.

There is a different issue in providing a setting in which the regional economic growth can recover these losses and ultimately raise standards of living above where they were to begin with. And the outlays for necessary infrastructure are part of that. But that is an economic impact that is longer term. So I do not think it is a competition so much at the moment as in when those impacts might be seen.

Mr. JEFFERSON. The other question was whether making these tax cuts permanent, particularly the dividend cut and the capital gains cut, will that help the hurricane survivors in this situation?

Mr. HOLTZ-EAKIN. The second aspect to the economics of this situation is the path of the national economy. And aggregate tax policy of this type is really about what are appropriate long-run incentives in the Tax Code for the aggregate economy. To the extent that it helps the individuals who have been harmed by these hurricanes, that will be through its aggregate economic performance.

Mr. JEFFERSON. We talk a lot here about incentivizing, and return of business and individuals to New Orleans—because I represent New Orleans—to the gulf region.

What sorts of incentives do you think are most effective in getting that sort of thing done, if you have had a chance to think about that, both in terms of their effect and their affordability?

Mr. HOLTZ-EAKIN. I think that an important consideration here is that there is a preexisting set of incentives that will have powerful impacts and have proven to have powerful impacts in the aftermath of past disasters.

They are the opportunities for individuals to make some money rebuilding houses. They are the opportunities for firms to supply those workers with the services they need to house them. And there is an enormous amount of standard environmental governmental policy that allows the private sector to function and where private sector incentives take care of a lot of things.

It may then be the case that particular additional policies require Government help, and that may be the infrastructure case. But I think those are the key things. Put in place the infrastructure and the environment, and rely on the broad set of incentives that are national economic policy.

Mr. JEFFERSON. Last thing. When you say rely on a broad set of incentives, since this disaster is such a tough one, can we rely on the normal incentives; or do we deepen them in these cases to further incentivize the location of business?

I remember Manhattan after 9/11. People said no one is going to go back there because they don't know if it is going to be safe. Here, of course, that question is even larger, because there is so much a broader effect and much broader area. So are we thinking about deepening the incentives as opposed to just relying on the ones that have been in place before that, even if they worked before?

Mr. HOLTZ-EAKIN. I think there will be an automatic deepening of private sector incentives. The question is really the degree to which it is effective to have targeted regional incentives in the aftermath of an event like this.

There have been attempts of this sort after 9/11, attempts in enterprise zones and various target policies within States. I would say a fair reading of the literature is that those are far from guaranteed for success, and certainly far from a guarantee to be cost effective.

Mr. JEFFERSON. Thank you.

Mr. WICKER. Thank you, Dr. Holtz-Eakin. It has been a very informative 2½ hours. This hearing is now adjourned.

[Whereupon, at 4:35 p.m., the committee was adjourned.]

