PRESIDENT'S 2003 BUDGET PROPOSALS FEATURING OMB DIRECTOR DANIELS

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BEFORE THE

COMMITTEE ON WAYS AND MEANS
HOUSE OF REPRESENTATIVES

ONE HUNDRED SEVENTH CONGRESS

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Wednesday, February 6, 2002

House of Representatives,
Committee on Ways and Means,
Washington, DC.

The Committee met, pursuant to notice, at 2:12 p.m., in room 1100 Longworth House Office Building, Hon. Bill Thomas (Chairman of the Committee) presiding.

[The advisory announcing the hearing follows:]

ADVISORY

FROM THE COMMITTEE ON WAYS AND MEANS

FOR IMMEDIATE RELEASE
January 29, 2002
No. FC–12

CONTACT: (202) 225–1721

Thomas Announces a Hearing Featuring OMB Director Daniels on the President's 2003 Budget Proposals

Congressman Bill Thomas (R–CA), Chairman of the Committee on Ways and Means, today announced that the Committee will hold a hearing on the President's fiscal year 2003 budget. **The hearing will take place on Wednesday, February 6, 2002, in the main Committee hearing room, 1100 Longworth House Office Building, beginning at 2:00 p.m.**

In view of the limited time available to hear witnesses, oral testimony at this hearing will be from the Honorable Mitchell Daniels, Jr., Director, Office of Management and Budget. However, any individual or organization not scheduled for an oral appearance may submit a written statement for consideration by the Committee and for inclusion in the printed record of the hearing.

BACKGROUND:

On January 29, 2002, President George W. Bush will deliver his State of the Union address, in which he is expected to outline his policy agenda. The details of these proposals are expected to be released on February 4, 2002, when the President is scheduled to submit his fiscal year 2003 budget to the Congress.

In announcing the hearing, Chairman Thomas stated: "The Committee looks forward to Director Daniels' appearance. His testimony will help give insight into President Bush's budget and lay the groundwork for the coming year's legislative business."

FOCUS OF THE HEARING:

The focus of the hearing is to review the President's fiscal year 2003 budget proposals.

DETAILS FOR SUBMISSION OF WRITTEN COMMENTS:

Please Note: Due to the change in House mail policy, any person or organization wishing to submit a written statement for the printed record of the hearing should send it electronically to "*hearingclerks.waysandmeans@mail.house.gov*," along with a fax copy to 202/225–2610 by the close of business, Wednesday, February 20, 2002. Those filing written statements who wish to have their statements distributed to the press and interested public at the hearing should deliver their 200 copies to the full Committee in room 1102 Longworth House Office Building, in an open and searchable package 48 hours before the hearing. The U.S. Capitol Police will refuse unopened and unsearchable deliveries to all House Office Buildings.

FORMATTING REQUIREMENTS:

Each statement presented for printing to the Committee by a witness, any written statement or exhibit submitted for the printed record or any written comments in response to a request for written comments must conform to the guidelines listed below. Any statement or exhibit not in compliance with these guidelines will not be printed, but will be maintained in the Committee files for review and use by the Committee.

1. Due to the change in House mail policy, all statements and any accompanying exhibits for printing must be submitted electronically to "*hearingclerks.waysandmeans@mail.house.gov*," along with a fax copy to 202/225–2610, in Word Perfect or MS Word format and MUST NOT exceed a total of 10 pages including attachments. Witnesses are advised that the Committee will rely on electronic submissions for printing the official hearing record.

2. Copies of whole documents submitted as exhibit material will not be accepted for printing. Instead, exhibit material should be referenced and quoted or paraphrased. All exhibit material not meeting these specifications will be maintained in the Committee files for review and use by the Committee.

3. A witness appearing at a public hearing, or submitting a statement for the record of a public hearing, or submitting written comments in response to a published request for comments by the Committee, must include on his statement or submission a list of all clients, persons, or organizations on whose behalf the witness appears.

4. A supplemental sheet must accompany each statement listing the name, company, address, telephone and fax numbers where the witness or the designated representative may be reached. This supplemental sheet will not be included in the printed record.

The above restrictions and limitations apply only to material being submitted for printing. Statements and exhibits or supplementary material submitted solely for distribution to the Members, the press, and the public during the course of a public hearing may be submitted in other forms.

Note: All Committee advisories and news releases are available on the World Wide Web at *http://waysandmeans.house.gov*.

The Committee seeks to make its facilities accessible to persons with disabilities. If you are in need of special accommodations, please call 202–225–1721 or 202–226–3411 TTD/TTY in advance of the event (four business days notice is requested). Questions with regard to special accommodation needs in general (including availability of Committee materials in alternative formats) may be directed to the Committee as noted above.

Chairman THOMAS. Good afternoon. Director Daniels, thank you very much for joining us. I am sure other Members will continue to come in.

As we have said at all three of these hearings, that the President clearly outlined that the 2003 budget is significantly different than the 2002, in large part based upon what occurred on September 11th, and that the budget for the fiscal year 2003 is sharply defined. This is what the President said: Win the war, protect the homeland, and revive the economy.

We have been carrying on discussions with the Secretary of the Treasury, Secretary of Health and Human Services (HHS), and with the Director of Office of Management and the Budget (OMB). It gives us an opportunity, I think, to examine the rationale that put together the package that we currently have in front of us. Oftentimes we focus primarily upon the policy in a particular area, and I hope everyone appreciates the difficulty of the timeframe of October, November, December, putting a fundamentally different budget together for January, and I know there were some very difficult decisions that had to be made.

And I compliment the Administration and the Director for moving forward and making some very difficult decisions. In the President's State of the Union, he addressed the need for a stimulus package that may not be moot, depending upon how the House reacts to decisions that have just recently been made in the Senate. And rather than reiterate the particular aspects of the budget as we have done in previous hearings, I will just say that, Director Daniels, it is a pleasure to have you with us.

And before I ask you to address the Committee, I will turn to the Ranking Member, the gentleman from New York, to see if he has any opening comments.

Mr. RANGEL. Well, thank you, Mr. Chairman. I just want to state for the record that this morning when Mr. Stark yielded to Mr. Cardin when I had an opportunity given to me for an opening statement, that I had not known that was going to occur. Having said that, I am very anxious that all of the Members have an opportunity to question the Director.

I just want to thank the Director for a review and a withdrawal of the comments that he made as relates to the New York congressional delegation attempting to secure the funds that we believe will be necessary to rebuild lower Manhattan. And I also want to thank him for his reiterance of the fact that we should be getting more than the $20 billion that had been promised, notwithstanding the fact that there was no comment made in the President's State of the Union message about the sacrifices that New York took for the Nation, nor did there appear to be any provisions in the budget which earmarked the funds that were promised. And even though you have said that you regret that your comment was misconstrued when it was—when you reportedly said that the New York lawmakers' efforts to get Federal money for September 11th-related costs was like a little money-grubbing game, accepting the fact that it was misconstrued, could you share with me what you actually meant? Because as the Senior Member of the delegation, we just want to do the best we can to service our constituents collectively and at the same time show our appreciation for the response that has been given to us, not only by the Congress but by the President. So I think we might use this exchange to clear the air and to move on, and I would like to yield to you.

Chairman THOMAS. I tell the gentleman that these were basically opening statements, and I was going to have the Director make his statement. And if the gentleman would allow, he could at the end of his statement accept that as a question and respond to that. So we might get on the record the Director's prepared remarks and then respond to Members' questions.

Mr. RANGEL. The Director can place it in any manner in which he wants in his response, but I do hope that he manages to include a response to my question.

Chairman THOMAS. I thank the gentleman. And any written statement you have will be made a part of the record and you may address this as you see fit.

STATEMENT OF THE HON. MITCHELL E. DANIELS, JR., DIRECTOR, OFFICE OF MANAGEMENT AND BUDGET

Mr. DANIELS. Thanks to you both very much.

Chairman THOMAS. You need to turn that mike on and then speak directly into it. It is pretty unidirectional.

Mr. DANIELS. How's that? Better? Many thanks, Mr. Chairman, many thanks Congressman Rangel. Let me show a little mercy and summarize very briefly the written submission that I have given the Committee. Then if I may, I would very much like to address Congressman Rangel's questions and then move on as you direct.

It is certainly true that in many respects we submit a different sort of budget this year. Much of that was already in process and I won't dwell on it. But I do hope that Members will find some time to examine ways in which this budget has a different emphasis, quite apart from the new situation that it addresses and the new priorities that it expresses.

And the novelty of this budget I would summarize under the heading of "accountability." We do try to take a long step to respond, really, to acts of Congress and calls from Congress for serious measurement of performance in government, at least to begin down that journey, and therefore we do venture to rate at least those few programs for which enough data exists. For far too many, we just don't have enough evidence to declare in either direction. And we also take very seriously the President's order that we try to manage the Federal Government as well as it can be, and there are rankings of the departments in terms of their starting point on the five biggest problems that we have embarked on trying to attack.

As to the content of the budget itself, the Chairman is quite correct that it deals overwhelmingly in its emphasis with the two-front war in which the Nation now finds itself and is by now I think pretty well understood, concentrates new resources overwhelmingly on the Defense Department where they are charged, of course, with victory in the war against terrorism as well as certain homeland defense assignments, and on those parts of the domestic government most relevant to the defense of Americans in their homeland. We double spending, a little bit more than that, in that category.

We seek to avoid the guns and butter mistake of three decades ago, and therefore apply these new tools of trying to separate programs that work from programs that don't, with special rigor, and have presented proposals that in the aggregate allow only limited increases for the rest of government; increases, I stress, but only at 2 percent. That is less than has been customary in peacetime recently.

I would ask you, however, to look below the surface of that number, because again, by separating carefully programs that work from programs that don't, programs that are relevant today from some that are—have seen their better days, there are some major increases. Research and development, parts of the education program and so forth come in for large increases, even within an aggregate that is held to what we believe is the maximum prudent level.

So let me close, Mr. Chairman, simply by pointing out that we like the situation of a return to deficits probably less than even the Members of this Committee. It is principally a factor, of course, of the recession. With the costs of war laid on top, we do find ourselves in a deficit position for the first time in a few years. I would point out to you by way of perspective, this is historically a very small deficit. It is the smallest recession-time deficit in the post-war period, and those other recessions did not bear the simultaneous burden of warfighting—those recession budgets.

The progress to which this Committee has contributed so much in recent years continues to pay real benefits, and we shouldn't overlook them, even as we work and worry about the deficits we have on hand. Just to cite an example, the interest costs, the interest burden on the Federal budget continues down and is below 9 cents on the dollar this year, and that is a great achievement that this Committee had a lot to do with. Just a few years ago, it was 16 cents, the first 16 cents of every dollar going for carrying charges, so to speak. So I think we have to keep some perspective.

We all seek an early return to balance, to surplus, to debt reduction, and we look forward to working with this Committee to do that.

Let me respond quickly to your question, Mr. Congressman. The President's commitment to $20 billion in reconstruction aid for New York City is inviolate. It is intact. And it is in process. And in fact, it will be exceeded, I haven't the slightest doubt. It will be exceeded before counting the other—another unprecedented and I think extraordinary gesture of support for New York, and that is the victims' compensation fund that was attached to the airline rescue bill. So without question, in my judgment, before we are done over $20 billion, not counting that amount.

This has been a week in which I am sure I have spoken several hundred thousand words in a whole variety of forums. At least one of them was really poorly chosen, and I take it back eagerly. What I meant and what I should have said was that the exercise at some points has been a bean-counting exercise or a numeric exercise in which people—it was hard to get people to talk about what are we going to get done, what will we rebuild, which buildings, which infrastructure, how fast and so forth. People only seem concerned about ringing up a meter counting the dollars out the door, and that is I think all I meant to say. And I am sorry that I said it so poorly.

But we are working very hard to make sure the President's commitment is fulfilled. More importantly, that the Federal Government delivers on the unprecedented list of things that it has already agreed to do in the case of New York, 100 percent, not something less cost of—as you know, of payment for so much of the—for all the damage that happened there and so many other things.

I would mention specifically to this Committee, as I did to two committees yesterday, a major piece of unfinished business that we now have to figure out a new—we may have to figure out a new way to accomplish, and that is the centerpiece of the economic development program that the city and State have requested. And that is the so-called "liberty zone" package. It was to be part of the stimulus bill, which came so close to passage before Christmas, and now is in real doubt, regrettably. And we remain committed to that package, Congressman, and would like your counsel and guidance about alternative means of moving it if the vehicle it has been on truly is stuck.

[The prepared statement of Mr. Daniels follows:]

Statement of the Hon. Mitchell E. Daniels, Jr., Director, Office of Management and Budget

My colleagues at OMB and throughout the executive branch have worked hard to present this Committee and our fellow citizens with a very different budget for the fiscal year 2003. Before turning to the traditional subjects of totals, balances, and specific policies, let me recommend to the Committee's attention some new features which I hope will now become part of your annual expectations and deliberations.

This budget takes seriously the assessment of government performance, and its relationship to future spending. Activities where effectiveness can be proven are maintained and often reinforced; those that demonstrably fail, or can make no showing of effectiveness, in many cases are looked to as sources of funding. The days when programs float along year after year, spending taxpayer dollars with never a showing of reasonable results or return, must give way to an era of accountable government. This and all future budgets must no longer be permitted to answer only "How much?" They must also address the question "How well?"

This innovation responds to decades of calls by good government advocates. While long overdue, it is especially necessary at a time when the physical safety of Americans requires that the Federal Government take on many additional, expensive tasks.

In the interest of both accuracy and sound management, this budget takes a major step toward full cost accounting of programs and departments by assigning the costs of health and retirement benefits to the places where those costs are created. At long last, the true cost of these programs will be visible, and managers will have full incentive to control the costs of additional personnel. Other disguised costs, such as the future liability associated with hazardous waste, remain and should be the object of further reforms.

The Unexpected Cost of the Recession

It has been clear for months—since September 11th to be precise—that our fiscal picture had changed in a fundamental way. The weaker economy erased $177 billion of revenues previously expected for 2002, and $120 billion for 2003. Additional spending to respond to the terrorist attacks in these years subtracted another $31 billion from the surpluses we all had anticipated. Over a 10-year period, for those still professing to find use in such numbers, changed economic and technical factors reduced the surplus by $1.345 trillion.

The recession that began in the first quarter of 2001 was the largest but not the only economic factor reducing estimated surpluses. The revised outlook for near-term productivity growth reduced the level of GDP—and hence the receipts base—throughout the budget window. Both the recession and the impact it has had on budget surpluses took us all by surprise.

As the *Washington Post* has noted, "2001 was a nightmare for economists," pointing out that, almost without exception, forecasters failed to see recession or its effects coming. In our misjudgments, our economists were in large and renowned company. The good people at the CBO, and 51 of the 54 private forecasters in the *Wall Street Journal* survey, all missed the recession even as it was well underway. The fact that our assumptions were toward the conservative end of the forecasting spectrum did not protect us from a very large misestimate. May I add that when the Nation's economists are having nightmares, budget directors lose sleep, too. We ultimately must choose assumptions that we believe will be accurate, and it is no comfort later that the rest of the world was in error, too.

The Administration stated from the outset that it would leave room for error, particularly when it came to longer-term projections. In mapping out long-term policy proposals, our Blueprint expressly marked off over $800 billion (15% of the total expected) as a Contingency Reserve in the event that the hoped-for surpluses did not materialize. At least as far as one can tell from the latest 10-year estimate, even this generous hedge was not enough.

The 2001 experience casts further doubt on the entire idea of 10-year budget forecasts. The attempt to see ten years out began only six years ago—prior to that time 5-year forecasts were the longest ever attempted—but already enough evidence is in hand to convict. The experiment with 10-year forecasts demonstrates that no one can reliably predict budget levels this far into the future. In fact, despite all the lamentations, this year's 10-year baseline surplus forecast is just as big as that of 2 years ago; even after tax relief, it is the largest ever except for last year's. If we had taken a one-year timeout from 10-year guesswork, no one would say that anything was "missing."

Our budget extends 10-year forecasts at the top-line level, for those still determined to find them credible, but it drops them from the rest of the document. There we return to the wisdom of our predecessors by using five-year numbers, which are plenty uncertain in their own right.

A Two-front War Against Terrorism

Mr. Chairman, we present this week a budget for a two-front war. It proposes substantial increases, those the President believes necessary to deliver on the paramount duty of the Federal Government, to secure the safety of the American people.

Last year's budget began the reconstruction of a neglected national defense base, and that project continues now with new urgency. The President asks Congress to support a 12% growth in base defense funding, part of this reflecting the new threats presented by a long-term terrorist foe. He also requests an additional $10 billion, if needed, for the costs of continued hostilities at today's levels.

Funding for the category of activities we now term "Homeland Security" will double under the President's plan: airline security, first responders, bioterrorism, border security and preventive law enforcement, are all scheduled for major increases as recommended to the President by Governor Tom Ridge.

We have worked closely with the Office of Homeland Security to define and budget for these activities; an explanation of the definition of the Homeland Security budget is attached at the end of my testimony. We will guard against and oppose efforts to divert funds from Homeland Security requirements or to misclassify unrelated funding under Homeland Security's priority status.

Winning our two-front war is not optional, and will be expensive. As in other times of national conflict, tradeoffs will be required. Other priorities will have to stand aside for a time, lest we commit the "guns and butter" mistake of the Viet Nam era. We propose a very reasonable level that allows spending not related to the war or homeland defense to grow by around 2%.

Within this "Rest of Government" category the President proposes $355 billion of spending. It must be noted that the activities it encompasses have enjoyed rapid funding increases during recent years, growing by an average annual rate of more than 8% since 1998.

Within this enormous sum, it is both possible and desirable to increase high priority programs of proven effectiveness, and this budget recommends many such increases. Dozens of programs across the government are scheduled for growth based on demonstrated results.

Measuring Performance and Delivering Results

For decades, good government advocates have called for systematic measurement of government's performance, and its reflection in the allocation of resources. In 1993, Congress passed the Government Performance and Results Act (GPRA), which was intended to implement this reform, but this mandate has been virtually ignored. The President's budget for 2003 responds to Congress' instruction, differentiating where the facts are available between programs that work and those that do not.

Many programs of proven effectiveness are strengthened, by shifting funds from those which can make no proof of performance. NSF, WIC, Community Health Centers, and the National Weather Service are among the best performers, based on clear targets they have set and hard data that says these goals have been met or surpassed.

A serious attitude toward performance is long overdue, but takes on special urgency at a time when the demands of national security assert a heavy claim on our resources. We hope the findings of this budget will trigger interest in performance assessment, and bring forth much new information about that large majority of programs for which we have no useful data at all.

Restoring Economic Growth

This budget funds a two-front war, but takes aim at a third priority as well, the struggling American economy. The President urges the Congress to act, and act quickly, on a jobs and growth package like that which passed the House but was blocked in the Senate just before Christmas.

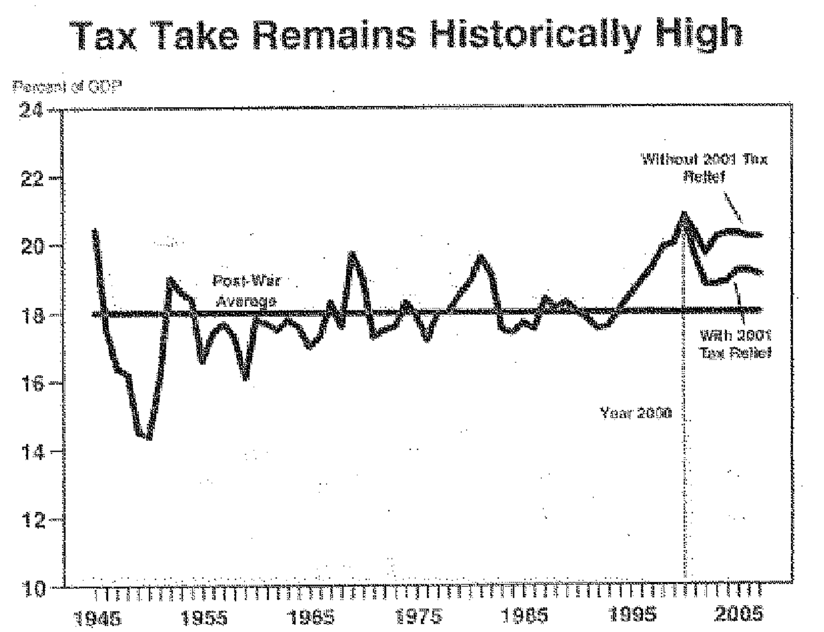
There are some encouraging signs of recovery, but the President is not satisfied to leave matters to chance. Government cannot "manage" the economy, but it should do what it can, and the President wants to act on a stimulus measure that might accelerate and strengthen recovery. While adding this action to his other budget proposals would likely make 2003 a year of a small deficit rather than a year of small surplus, the President favors the tradeoff in favor of jobs and growth. Past the short term, it is only rigorous economic growth that can restore surpluses in any event.

Conclusion

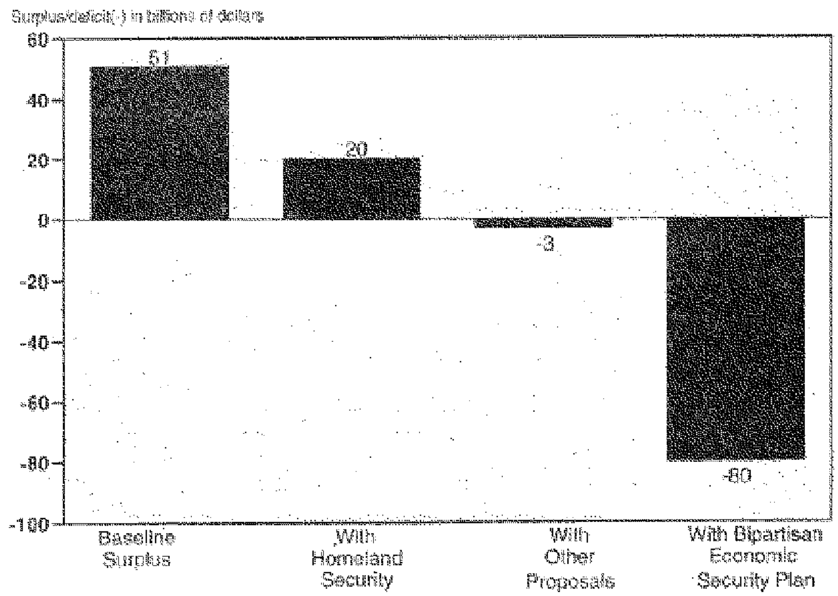
In sum, we should count our national blessings. Despite simultaneous war, recession, and emergency, we are in a position to fund the requirements for victory, plus a stimulus package, and still be near balance. The deficit we project will be the Nation's smallest in times of recession since the early 1950s.

Interest costs to the Federal Government will continue to decline; interest payments will fall below 9¢ of each budget dollar for the first time in 22 years. Despite everything, the outlook is promising for balance in the year after next, and for a return to large surpluses thereafter.

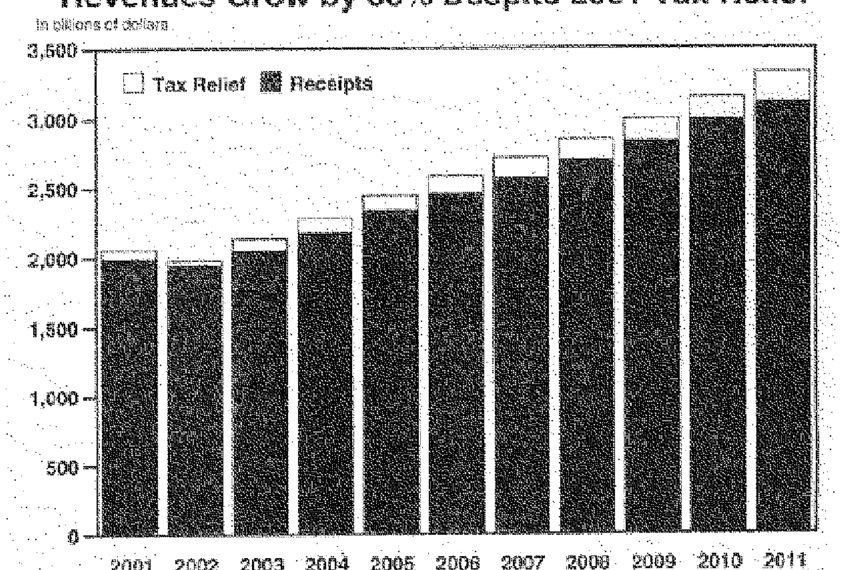
The President's proposals thus do what must be done, while protecting our fiscal future. It is a privilege to submit them for the Committee's review.



Evolution of the 2003 Deficit

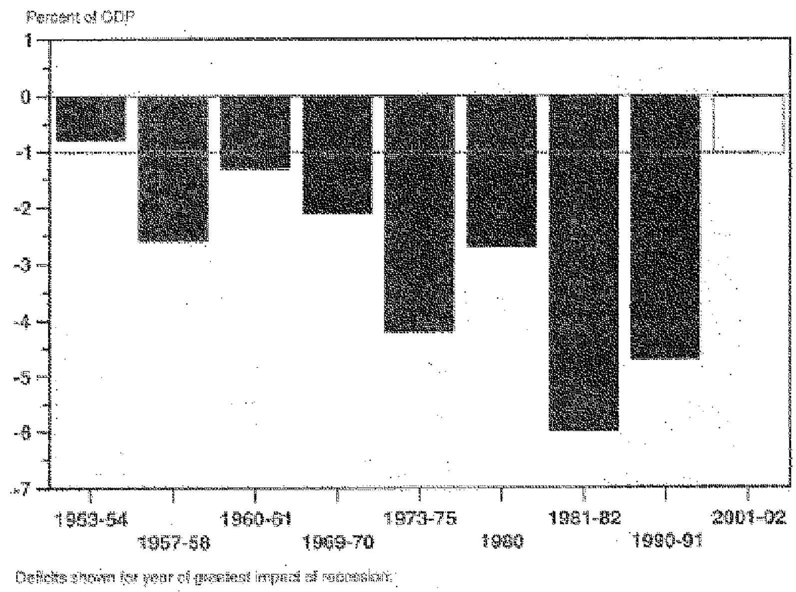


Revenues Grow by 55% Despite 2001 Tax Relief

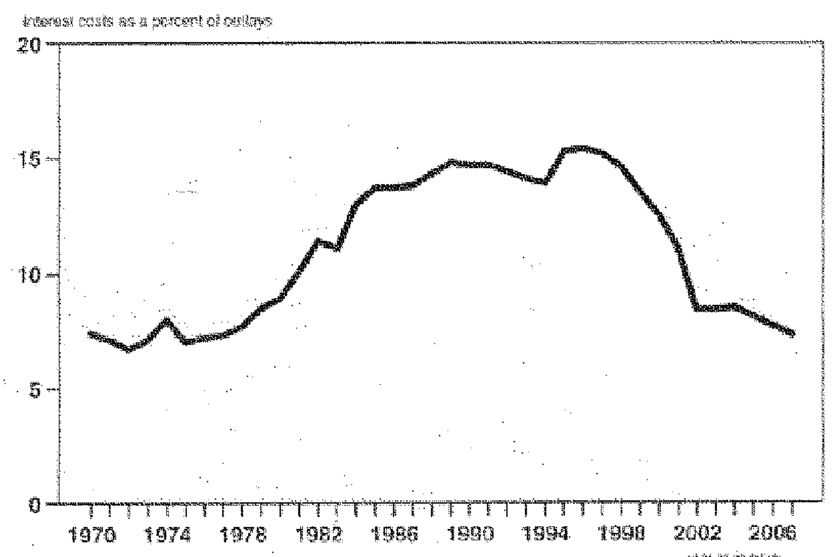


Note: Tax relief includes proposed extension of provisions beyond 2010.

Smallest Recession Deficit in 50 Years



Government Debt Burden Continues to Fall



Mr. RANGEL. Well, let me thank you for the clarification, but are you suggesting in the bean counting that the delegation is involved in, that——

Chairman THOMAS. The gentleman from New York is recognized.

Mr. RANGEL. Thank you so much, Mr. Chairman. That my Mayor and Governor has not given you the blueprint that you feel comfortable with in terms of allocation of additional funds?

Mr. DANIELS. No, sir, not at all. In fact, I think the blueprint is pretty clear, and it is an exciting one. I only mean on some occasions it has been hard to talk about the blueprint, the "what will we do," because people seem to want to stop and start with what will it cost. And my view is it will cost what it costs. Let us get the job done, and I am confident when we do count the beans later on, we will see that it was well in excess of $20 billion.

Mr. RANGEL. I look forward to working with you toward that end. Thank you, Mr. Chairman.

Chairman THOMAS. Thank you, Mr. Rangel. And it is somewhat melancholy now to look back on those days in December when we were over working with Senator Schumer on a package that was absolutely completed but did not move because the stimulus package at that time did not move. My understanding is in the Senate now, the package is down to unemployment insurance. That may not be enough room to place a vehicle, and I would be interested in working with the gentleman from New York, if in fact we might be able to put that as part of our contribution on a package going back. There may not be that many vehicles moving back and forth.

And I would invite, Mr. Director, your response, and I realize that the Administration perhaps hasn't sat down and examined the decision over on the Senate to send only unemployment insurance (UI) over as the best they could do for a stimulus package, and whether or not we might want to embellish that a little bit over here with what would be considered on a bipartisan basis worthwhile additions.

One of the questions that I want to ask you, and I will provide in written form, was one that I presented to Secretary Thompson, because it is difficult to understand. Sometimes when you are looking at the budget to fully reconcile how pieces go together, and the concern that this Committee has, given its major responsibility on Medicare, is that, one, we commend the Administration for placing $190 billion in the budget. That is the same number that was in there last year. Last year it was $190 billion in the surplus environment, and now it is $190 billion in a potential deficit environment. Those aren't the same $190 billion. The ones this year are much dearer, and we appreciate that. But we have also looked at a program that is a low-income Medicaid convertible to Medicare drug program that has, I believe, costs in the vicinity of $77 billion over 10 years. Additionally, the Administration has said they want to up—to enhance the Medicare+Choice by about 6.5 percent.

When you add all of those dollars and subtract them that are in the budgetary structure, you are down around $115 billion available. When you look at the MedPAC or Medicare Payment Advisory Commission, the group that recommends to us, updates for physicians, for example, which over a decade ballpark at about $80 billion, assistance to hospitals, dialysis facilities, the home health,

$115 billion left over from previous statutory language, we are looking at almost $100 billion coming out of providers. And what we could get out of the Administration's budget was that those adjustments will come from providers. And that is fairly difficult when the whole pot, as people are looking at it, is somewhere around an additional $100 billion. And the ones who receive the largest amounts, the physicians in the hospitals, are the ones who are out front in terms of augmentation of current amounts.

So when you put those two together, it makes it very problematic to figure out how we can get where we need to go. So we will submit that in written form and would request—and we will coordinate with HHS that you would give us just a little bit of guidance in terms of the directions as to where we may go.

[The information follows:]

Question: The President's budget provides $190 billion to modernize the Medicare Program, add a prescription drug benefit and take steps to strengthen the existing Medicare+Choice program. Meanwhile, MedPAC's recommendations for provider payment changes would cost over $100 billion, but the budget says that any changes to Medicare provider payments need to be done in a budget neutral manner across providers. How is the Congress supposed to pay for MedPAC's recommendations?

Answer:

- The President's priorities for Medicare are to:
  - quickly phase in a drug benefit for low-income Medicare beneficiaries, that will transition to the comprehensive benefit available when the entire program is modernized;
  - sustain and enhance the options available to beneficiaries in Medicare+Choice; and,
  - modernize the Medicare Program in order to provide a comprehensive prescription drug benefit and improve health insurance plan options, consistent with the principles the President outlined in July 2001.
- The $190 billion included in the FY2003 President's Budget is dedicated to providing funding for the President's priorities discussed above. This money is not meant to be used for increasing payments to fee-for-service Medicare providers. In fact, the Budget also states that the Administration believes any changes to fee-for-service payment policy must be budget neutral in both the short and long term, across provider payment updates.
- The Administration recognizes that Medicare's current administrative pricing system creates extremely complex provider payment systems that do not always function smoothly or equitably. In fact, these shortcomings of the existing payment systems further underscore the need for fundamental reform of Medicare.
- However, a modernized program cannot be implemented immediately; therefore, the Administration is willing to work with the Congress to look at short-term modifications to provider payment systems in order to address payment issues.
- Furthermore, as we consider changes to payment systems, we need to be cautious and recall that any increases in spending will be borne in part by beneficiaries in the form of higher premiums and coinsurance payments.
- The Administration is willing to consider any needed adjustments to payment systems and to work with Congress to develop a package that is budget neutral across providers. To this end, we point out that some provisions in law that have held downpayments in the past are about to expire, and extension of these provisions is one means available to ensure a budget neutral package of reforms.

Chairman THOMAS. The Chair would say that we have a current vote on, but the Chair plans to proceed directly through the vote in exchanging chairs, and would begin calling on Members, with the agreement of the Ranking Member, on those who did not have the ability to participate in the last questioning period.

So with that, I would turn to the gentlewoman from Washington and ask her if she has any inquiries.

Ms. DUNN. Thank you, Mr. Chairman. I do have some questions I would like to ask. I am a little concerned about the time left on the vote.

Chairman THOMAS. We have 5 minutes. And if you want to go over and vote, the other two Members can go. I was anticipating some Members coming back so we could continue. And if the gentlewoman has not yet voted, I would suggest that she probably wants to go over and vote and then come back and——

Ms. DUNN. If I could trade my time, I would sure appreciate it.

Chairman THOMAS. And we will pick up the Members in that order. Have you voted?

All right. Tell the Director that as soon as a Member comes back, that we will begin the questioning, but we are inside 5 minutes on the vote. So the Committee stands in recess until a body arrives.

[Recess.]

Mr. HOUGHTON. [Presiding.] Okay. We can reconvene the meeting. As the Pro Tem Chairman, I would like to ask a question. Most economists thought that there would be sort of a minus 1 percent drop in the gross domestic product (GDP) and were surprised by the figure that came out that was sort of modestly on the plus side, and a big, big shrinking of inventories.

So I think with that as a backdrop, the question that I would like to ask you, Mitch, is this: How do you see the overall stimulus package in this context? Should we do it? Should we not? Does it help the economy? Doesn't it? Where do you come down on this?

Mr. DANIELS. First of all, it is important that any stimulus package stimulate. And from the beginning of this debate, the President has made the point that it is very important that any package Congress agrees on, that he would sign, would have to have as its principal purpose generating jobs and economic growth, and a lot of ideas can travel under the same flag.

And so I will simply want to reaffirm that the content of the package is very important; that while it needs to help dislocated workers, for example, to merit the label and to merit his signature, it is going to have to show some possibility of really making a difference of some kind in the timing and the strength of a recovery.

Now, the President's position remains that the promising signs we see are encouraging but not sufficient to persuade him that we have done all we need to do. And I think he was very disappointed at the apparent inability of the Senate leadership to follow the House's example and pass a satisfactory package. And he remains hopeful that we will find a way yet to do this.

In our budget, we took our cue from the Council of Economic Advisers, which believes that a package along the lines of the one that passed the House would add perhaps a half a point to economic growth, and that is perhaps 300,000 jobs at the margin. And that is certainly something worth doing and still worth doing, even though there are some signs of recovery already around.

Mr. HOUGHTON. Well, one of the arguments, of course, is that if—and I don't necessarily hear this—that if you have an economy which is doing better than you had thought, is on the way up, and you don't have a stimulus package, you actually get back into budget balance much sooner. How do you feel about that?

Mr. DANIELS. It is certainly true that a bigger stimulus package would add a little bit of red ink. In the near term, very likely would—if it was effective, would reverse that effect and would produce more black ink over the long term. The President is prepared to make that tradeoff, but the people holding the view you just mentioned are generally accurate on the OMB baseline, which is slightly different than CBO's or Congressional Budget Office. The 2003 budget we have presented, in view of everything, in view of the recession, in view of the war costs, in view of the extra needs for homeland defense and so forth, is in balance, before taking the step of an economic package. The President's choice was to go ahead and act. He had always said that in normal times the budget should be balanced; but a recession, along with war and emergency, was an acceptable reason for a deficit. And that is precisely the choice that he made in presenting this budget.

Mr. HOUGHTON. Let me just ask you one further question, and then I will pass it along to the others. So it looks like the Senate is virtually going to do nothing except pass over unemployment insurance. If there were one or two other things you think are essential that we ought to be considering as a throwback to the Senate, what would those be?

Mr. DANIELS. The Administration hasn't made a decision as to rank-ordering the elements. The President liked the elements that were in the House-passed bill. The rate reductions in the middle brackets would probably be very high on our list. We think those have both the best near- and short-term—I am sorry, near- and long-term effectiveness. Immediate aid to consumers even at the lower income brackets, and of course investment incentives. But for the moment we haven't given up on the idea we could do all of those things, or things like them, and so I am not able to tell you yet that the President would pick just one out of—or which one he would pick if he was limited.

Mr. HOUGHTON. Thank you very much. Mr. Crane.

Mr. CRANE. Thank you, Mr. Chairman. Director Daniels, quite simply, I am thrilled with the President's budget. It strikes the right balance between necessary spending on national security and continuing the tax policies that were begun last year. However, allow me to suggest there may be one thing that might improve the accuracy of this budget. You recognize we are locked into a revenue estimating scheme that does not take into account the real-world effects of tax policy. We act as if there is no budgetary benefit from sound tax policies like reducing marginal rates or capital gains or increasing incentives for savings. Yet we know these changes have a positive effect on the economy. And I just got a report here of the effects of the stimulus bill passed by the House, and the stimulus bill was estimated by the White House to raise GDP by five-tenths of a percent in 2002 and create 300,000 new jobs. And without the positive economic growth effect of the stimulus bill, the 10-year surplus, 2002 to 2011, would be $175 billion lower. And the estimated 10-year costs of the stimulus bill passed by the House in December is $157 billion. Therefore, by killing the stimulus bill, we lose an estimated $18 billion in receipts over 10 years and prevent 300,000 jobs, about half the size of a congressional district.

Mr. Director, what suggestions do you have to improve the revenue estimating process so we can get a real-world assessment of the tax cuts included in the President's budget, and would you consider these process improvements when writing the 2004 budget plan?

Mr. DANIELS. Now, this is a very important and longstanding question, Congressman. You are absolutely right that we need a better way, that today by convention we are not at liberty to break from presently, unilaterally at OMB. We make the one assumption that we know is wrong. That is, that lower taxes have a zero effect, and honest people can differ about how big the effect of any given measure might be, but the answer we know is wrong is the one we use. And I am hopeful that some progress will be made. I know that professional economists have worked very hard in these last decades to try to get to some accuracy about this, and there are models around that I think we could use. It does take the agreement of various parties, including the Congress, the CBO and so forth. And I think maybe the current situation reminds us again we ought to get serious about it.

Mr. CRANE. Well, I would hope that we could get serious about it sooner rather than later, because unfortunately it becomes a political game. And who is in charge—oh, you are back. Okay. I yield back the balance of my time. Thank you.

Chairman THOMAS. [Presiding.] The gentleman from Massachusetts wish to inquire?

Mr. NEAL. Thank you, Mr. Chairman. Mr. Daniels, you have referenced twice the stimulus bill that came from the House. Do you favor repeal of the corporate alternative minimum tax (AMT) retroactively?

Mr. DANIELS. It could be acceptable to the President in an otherwise adequate package. You said just corporate—repeal prospectively?

Mr. NEAL. The first stimulus package that passed the House.

Mr. DANIELS. Well, the first one, as I recall, included a refundability provision that we did not embrace; no, not that. But the notion that at least looking forward, the corporate AMT left as it is would moot or vitiate the job creation effects is something that we—that the Administration did find persuasive.

Mr. NEAL. But did you favor it or not favor it?

Mr. DANIELS. As originally passed in the House?

Mr. NEAL. Yes.

Mr. DANIELS. Never took a position on it, but it was not a part of the principles—a part of the principles that the President had laid down for stimulus. And I want to say that I personally felt it was not going to be and probably shouldn't be part of any final package.

Mr. NEAL. No. Fair enough. And, look, I appreciate it. You have got a tough job. You have run into a buzz saw a couple of times by comments that you have offered. And some of the comments, at least as it related to the appropriations process here, I thought were kind of interesting in the sense that we ought to have maybe a truth-in-spending bill around here that everybody signs onto, and the same people that preach fiscal austerity on the House floor typically load up. And it is not the Republican appropriators, incidentally. It is other Members of the House that typically send more letters seeking more funds for more projects than anybody else does. At the same time, they have the opportunity to rail against excessive spending on the House floor.

And so when I watched you a bit caught off guard with those comments that you made, I thought it was kind of interesting that you might be speaking to an issue around here that has gone on for a long time. And I am told by friends on both sides of the aisle that the biggest letters that they get in terms of requests for expenditures oftentimes come from those who preach fiscal sanity on the House floor. And maybe just releasing some of those letters around here at some point for the things that they ask—and you might want to be part of that, Mr. Daniels. You are not going to get them any madder at you than they were then. I mean, it is as simple as that.

But let me get back to the questioning. The reason I raised that question with you about corporate alternative minimum tax, in the budget request it didn't address individual alternative minimum tax, and I have been on this for a long time. Mr. Thomas has said it is his desire to take the issue up at some point. Well, we are into another setting, another budgetary cycle, and the problem is really getting worse for a lot of people. It is suggested that it will rise from 5.6 million people in 2004 to 13.4 million people in 2005. Would you deem this to be a tax increase on 13.4 million people?

Mr. DANIELS. Well, I would certainly deem it to be a large problem, and I think you are to be commended for advocacy on this issue for a long time and for keeping it in the forefront of people's attention. It deserves to be. The tax relief measure of last year did, you could say, buy us some time, I think to 04, but this needs to be addressed. The Treasury Department at the President's direction is working right now on a study of tax simplification that very likely will—it will have to treat with this issue and very likely I think will come up with ideas for resolving it while we—during this interval. But it is certainly a problem that I think most parties agree needs to be taken care of.

Mr. NEAL. I appreciate your candor. I had a chance to sit next to Andy Card recently, and we discussed that whole notion of tax simplification, which we have had a pretty good bill I think that has been hanging out there for a while, and I would be happy to join the other side here in, because——

Mr. DANIELS. Well, we would value your ideas.

Mr. NEAL. That is the kind of issue that I think would really help the American people as opposed to much of the endless debating we do here.

So you weren't in favor of the repeal of the corporate alternative minimum tax, but you think we ought to do something about individual alternative minimum tax?

Mr. DANIELS. That is correct.

Mr. NEAL. You couldn't give me a better answer. I appreciate that very, very much. Thank you, sir.

Mr. DANIELS. Yes, sir.

Chairman THOMAS. The gentleman would tell the gentleman from Massachusetts, although it has been characterized as the corporate alternative minimum tax, even in the initial effort of the Committee—and I appreciate the gentleman from Massachusetts staying away from the second offer, which was not the repeal but significant reduction and a virtual appeal for those who fit the category—in both of those instances, there were individuals who would have been relieved of the alternative minimum tax. It does, of course, carry with it a majority of corporate structure, but there are individuals who do pay through that tax structure. And since the gentleman mentioned the Chair's interest in the individual alternative minimum, as the gentleman well knows, it stems from the last tax package from the majority—then-majority, in terms of moving the regular tax depreciable schedule away from the alternative. And the gentleman is correct. It continues to grow.

To me, the fundamental hurdle in resolving it is the fact that it is now going to require about $500 billion, half a trillion dollars, to address a problem that had his party, when they had been in the majority addressed it, for a very modest amount would have corrected it. But the goal of seeking revenue overruled the appropriateness and fairness of modifying or even eliminating that alternative minimum tax.

I appreciate now the gentleman's late coming to the need to resolve that issue, but this is truly one which is going to be very difficult for us to embrace. I want to underscore the gentleman's initial comments about it being only for corporate was simply not true, either in the first version of the stimulus package that passed the House or the second.

Mr. NEAL. Mr. Chair, would you yield for a question?

Chairman THOMAS. Certainly.

Mr. NEAL. I think the point that I tried to raise here was that there was a certain enthusiasm here for repealing corporate alternative minimum tax. Well, we have kind of danced around the issue of alternative minimum tax for individuals. And all I am suggesting is that time—and again I think the Committee and I think that your comments have been entirely sincere as they relate to doing something about alternative minimum tax—but in the closing moments of last year, we were able to rush through a package which the Administration apparently, on corporate alternative minimum tax, didn't support; and we would have had an opportunity here, I think, even in increments, to address the individual alternative minimum tax.

And I hear it all the time from accountants. I hear—and incidentally, the accountants that I hear from are almost all Republicans—that their employees and the people that work with them and the people they work for are all complaining about this issue. And think that I accept your word, and have entirely, and I would like to get to that at least in some measure if we could this year.

Chairman THOMAS. Once again, to make sure that the record is correct, the Director responded to your question on the initial stimulus package which was passed in October, which did have the repeal of the alternative minimum and the redeemability of the credits, which was not retroactive. I believe the President has gone on record, including most recently in the State of the Union, that he was in support of the second stimulus package that passed the House, which did not repeal the alternative minimum tax but rather made fundamental revisions to it. So if the gentleman is referring to the December-passed stimulus package as the one that we rushed through the House, that question was never asked of the Director, and I believe if that question were asked of the Director, he would say that the Administration supported the December stimulus package. Is that correct, Mr. Daniels?

Mr. DANIELS. That is correct. And if I misunderstood the question, I apologize, but that is correct, and I think the earlier question did refer to the first version.

Chairman THOMAS. That is correct.

Mr. NEAL. Mr. Chairman, could I prolong this for a bit? My point is simply this—and if I could just go back to it. We have talked about it here, time and again, and the problem only gets worse. All I am suggesting is that a good sit-down with the minds in an attempt to address this in a fair-minded fashion.

Chairman THOMAS. The Chair will underscore, and then move to the next questioner, that the Chair has no problem with the gentleman stating his position. It is when the record is made which is factually inaccurate that the Chair feels the necessity to intervene. The Ranking Member has indicated that the Chair seems to intervene fairly frequently. If the comments were more accurate, the Chair would not feel that need as frequently as he does.

The gentleman from Pennsylvania wish to inquire?

Mr. ENGLISH. I do, Mr. Chairman, and I will keep my remarks accurate and within 5 minutes. Thank you.

Mr. Daniels, it is a privilege to have you here, and I first of all want to associate myself with the remarks at the beginning of the hearing by the Chairman when he raised the point that because of the funding stream that you have outlined for Medicare, whereas you have I think provided adequate funding for hospitals. You have addressed many of our immediate needs. We are concerned that there are still some legacy issues left from the Balanced Budget Act that we would like to address and that we don't have the revenue to do it. And I would simply like to say I hope we are going to be able to work with the Administration to find a way of addressing some of those issues, whether it—whether the approach is budget-neutral or not. And, again, I realize you have to—you have to be very concerned about the bottom line. We also have to be very concerned about some of the reimbursement policies that are currently enshrined in law and need to be revisited.

On an entirely different issue, Mr. Daniels, I wonder did the President's budget envision any change in the earnings limit for the nonblind who are on Social Security?

Mr. DANIELS. I've got the answers to at least 10,000 questions in my head, but I think that is 10,001. Can I answer you on paper?

Mr. ENGLISH. May I simply leave it with you and suggest that the President has the capacity to raise the earnings limit for individuals who are on Social Security, some of the most vulnerable in our society. Under the last Administration, I think in 8 years they only raised the earnings limit once. That earnings limit no longer provides what it once did, and there are some workers who are working, notwithstanding their limited capacities, who are unable to work full time on the minimum wage because of the current very low threshold. And I think from a standpoint of compassionate conservatism, giving these people an opportunity to work, giving them an opportunity to become self-sufficient, is in everyone's interest and probably won't yield the costs that perhaps a revenue estimate would suggest. So I simply will leave that with you.

On an entirely different issue, I am very——

Mr. DANIELS. Before you move on, Congressman, let me say if I interpret accurately the mumbles behind me, the answer to your question is no, but I appreciate your bringing it up, and we will have a look at it. I suspect, as you, that in some state, this will seem both fair and affordable.

Mr. ENGLISH. And I am grateful to you for that indication. I have been reviewing your unemployment insurance proposal. I want to salute you for lowering the trigger for the extended benefits program, but I am concerned about the phasing out of Federal financing for unemployment insurance and employment service operations. My concern is this—and if I misunderstand—I understand you are providing full discretionary funding for 03 and 04, and then you are providing matching funds for 05 and 06, and after that participation by the Federal Government in funding these vital operations would be phased out.

What kind of an impact do you expect that to have on the commitment of States to provide these functions; and, two, once the Federal funding is gone, how much standardization is there going to be nationally in how these services are provided? Specifically what I am curious about is will employment services still be provided by all of the States? What guarantee do you provide of that?

Mr. DANIELS. Congressman, you ask what impact I expect. The answer to that is a highly favorable one. We are living with a legacy issue, to take another of your terms, here that has been hanging around a long time. It is a very antique, I have said, sort of jury-rigged affair, and we think it ought to be reformed in a methodical and gradual way. The proposal here, of course, would not touch benefits at all, only the Administration.

Right now, States see dollars, really excessive dollars, taxed away from their businesses. They come to Washington. They are held in a fund. Occasionally we leak out a few back. And this proposal that Secretary Chao and our people have come up with we think will enable States first of all to have more resources or at least have control of the resources. We would—part of this would be to disburse $9 million of Reed Act money to the States. As the Federal tax is lowered, it makes room for the States at their discretion to replace those funds if they need them.

We think in the end you would see more attention to administrative efficiency, more flexibility in the States, and frankly, to get to your last question, the employment services would probably become a bigger and then more effective part of our unemployment system than they are today. So I do commend it to the attention of the entire Committee. This—I really think this has the prospect to be a reform that could have a lot of bipartisan enthusiasm. It is complicated, and fortunately you have at least one of the Congress' genuine experts on this subject among your number. Congressman McCrery can do a better job than I of explaining it to you.

Mr. ENGLISH. Well, I don't have Mr. McCrery's expertise and my time has expired, but I look forward to seeing your legislative language and working with you if I can.

Mr. DANIELS. Thank you, sir.

Chairman THOMAS. Thank the gentleman. Does the gentleman from Tennessee wish to inquire?

Mr. TANNER. Thank you, Mr. Chairman. Thank you, Mr. Director for being here. It comes as a disappointment that we are in, I would say as a country, a markedly less financial position of strength than we were last year. Would you agree?

Mr. DANIELS. Yes, but I think we are all disappointed.

Mr. TANNER. Last year the budget surplus at CBO estimated for this year was $313 billion. OMB was $284 billion. This year that has been revised, and there has been a $333 billion reduction in the projected surplus this year. CBO gives three reasons for this: legislative action, nondefense discretionary, defense, June tax cut and so on, economic adjustment and technical adjustment. But to say if you put all of these into a percentage—and I want to ask you if you agree—about 72 percent of this total of $333 billion reduction in the projected surplus for this year due to economic changes, 11 percent for defense spending and 9 percent and so on, would that be a——

Mr. DANIELS. Yes. Those are either exactly or very, very close to any numbers that I have seen. The economy and the recession that we are in has had the effect that recessions have always had, and that is to take us into the red.

Mr. TANNER. I agree. Now, the 10-year projections CBO also has made—I didn't find it in your document as a 10-year, but that shows a total reduction of $4 trillion, and again they give the same three reasons for this change: legislative action, economic adjustment, in this case $653 billion, and technical adjustments, $453 billion. But if you add up the legislative changes that CBO says are the reasons for this adjustment of $4 trillion from $1 trillion—or $5.6 trillion to $1.6 trillion, what one finds is that it only adds up to $3 billion in terms of the changes.

The other $3 trillion—the other trillion, of course, comes from increased interest costs. Would you—to make the $4 trillion, according to CBO.

Mr. DANIELS. Right. And if you believe we have any ability to see that far into the future, which I am skeptical of.

Mr. TANNER. Well I am, too, and that is what I said last year when you were here telling us there was money as far as the eye could see and that we had plenty of room to do everything. But 70 percent of the surplus that we talked about last year, this $5.6 trillion, wasn't supposed to show up till the last 5 years, 10 years. And I couldn't agree with you more. That is what we said last year, and we said we were "banking on the come" too much. But anyway, that is a different story.

What my point is, is that if one looks at these 10-year numbers, one can readily see, according again to CBO, that legislative action has accounted for in their numbers about 60 percent of the change of this $3 trillion, with the tax cut being 42½ percent of that 60. This is what they say based on what—the same sort of protocol that they did.

The only point to all of this, Mr. Director, is we are, short term, in a recession and, short term, in a war. I think we know that that has had a dramatic impact on this year. The same can't be said for any of these 10-year projections. The same can't be said for your 5-year projection in terms of what we are doing. Nobody expects the recession to last for another 5 years. At least they haven't said so.

So my point is, when we on this side are criticized—and have been for the last 2 hours—about saying that everything ought to be on the table when they turn around and our financial outlook is this dramatic, that everything ought to be on the table, we are criticized as saying we want to raise taxes because some of these tax cuts that are supposed to take place in the outyears that have not yet become law, if we do anything to stop that or otherwise hinder it, defer it, or anything else, we are tax-raisers.

Now, do you believe, given this financial outlook, that everything ought to be on the table in this hole we find ourselves in?

Mr. DANIELS. Well, sir, a couple comments. One is that I haven't given up at all on the possibility that we will be back in surplus and back to reducing debt very soon. I have got a chart here somewhere.

Mr. TANNER. I don't either. But I am saying, don't you think we ought to put everything on the table if we see next year that we are still in this sea of red ink?

Mr. DANIELS. It is perfectly within the rights of Congress to look at these things all the time. I would say to you that I share your skepticism about long-term numbers and said so 100 times last year, too. As your question pointed out, the revenue associated with the tax relief bill of last year phases in very—the revenue change phases in very, very gradually. It is the position of this Administration that this is not an undertaxed society. We are taxing the American economy at rates well above the post-war average, even after tax relief, and I think we have to be very careful raising that level of taxation any higher. But——

Mr. TANNER. I am not talking about raising taxes. I am talking about putting everything on the table.

Mr. DANIELS. Really, I am not here to engage in the semantics game of whether—you know, a repeal or postponement is an increase and so forth. Just personally I don't think that gets us too far. There is a legitimate debate, however, between higher rates—higher total taxation and lower. And I am just saying, even after tax relief, I believe 19 cents on the dollar across this time period, the taxation of the economy is pretty high. We ought to be—it might be very counterproductive to let it become higher.

Mr. TANNER. I agree.

Chairman THOMAS. The gentleman's time has expired.

Mr. TANNER. May I have 30 seconds?

Chairman THOMAS. You get one more bite at him.

Mr. TANNER. Here is the only point I am trying to make, Mr. Director. We already are $3 something trillion of money we pay interest on every year. We are going to be borrowing some more in the short term. Now, it seems to me to be almost—reach a moral question when we send young people in uniform to fight for this country in Afghanistan and then ask them and their children to pay for it because we are borrowing the money to do it, while we take a tax cut; that we are accused of trying to raise taxes if we say, wait a minute, we are borrowing money that they have got to pay back, and they are doing the fighting and we are taking the tax cut now in my generation. That seems to me that that makes a strong statement that we ought to put all of this on the table if we find ourselves this way next year. And that is all I ask you to agree to.

Chairman THOMAS. The Chair believes the gentleman's question was rhetorical. The gentlewoman from Washington wish to inquire?

Ms. DUNN. I do. Thank you very much, Mr. Chairman. And welcome, Mr. Daniels. We are happy to have you here. I wonder if we could put that chart back up that you put, the chart before—no, with the bar graph. I think that is a very important chart. I can't see it right and clearly from here, but it looks like it is the chart that says we will be in deficit for 2 years and we will work our way out of deficit to end up with a $1.6 trillion surplus after 10 years. Is that correct?

Mr. DANIELS. Your statement is correct, although that is not what the chart says. You are pretty far away from it over there. You mind if I tell you what it says?

Ms. DUNN. Go ahead.

Mr. DANIELS. It simply shows how wildly these 10-year forecasts vacillate. Because everybody understandably has focused on last year—the second one from the right, versus this year—and saying, notice that the projected surplus, still a surplus, has come down. Most people haven't noticed that—except for last year, this is the best outlook we have ever had. It is the biggest 10-year surplus we have ever projected. And what that says to me is we can't rely very much on these things. They are interesting to look at.

I have every hope that if the economy should come back strong, we could be back here next year looking at another sort of outlook that Congressman Tanner regrets that we don't have anymore. But your point is a correct one, and we are looking at substantial surpluses, even given the circumstances.

Ms. DUNN. And I think that is an important thing to keep in mind, because the way I have heard this reported through the media is that we are in dire straits and we will never be in surplus again. And in fact we have been in deficit for many, many years up to about 4 years ago, in which we had 4 years of surplus. Now we are looking through 10 years of ending up with a surplus of $1.6 trillion. I think that is a very, very good goal and as tight-fisted as this Administration appears to be, I think it is a goal that we could hit.

But I did want to go back to the one point that I heard that Mr. Tanner made and just ask you a question. You have often objected to the long-term revenue projections that we had to make in the Congress. I don't remember doing this until a few—couple years ago, when the Senate brought us over to their side of the street—because it seemed to me we had usually projected in 5-year increments. I am wondering if you could comment on that. Is there some economic theory behind this, other than the unpredictability of the longer term prediction?

Mr. DANIELS. No. Your recollection is correct. For most of American history, we didn't look out further than 3 years, and from the early seventies to 6 years ago—5 years—and this 10-year, I would say experiment, is of pretty recent vintage. And when you look, again, at how erratic these numbers are, I think that at a minimum it means that we have to not rely too heavily on them or trust them too much. And I understand the reasons why the experiment was begun, but I think that we have learned how problematic they can be and how they can sometimes lead us into some long and not very useful arguments.

Ms. DUNN. Yeah. And I think the problem is just what you say. All of a sudden the projections become the battle, and even when they are not accurate and probably wouldn't be accurate, depending on changes in behavior, we still seem to hook onto them. Is there any effort to change us back to a shorter term scoring system?

Mr. DANIELS. We certainly need to secure the agreement of Congress to do that, but in the budget we have submitted, we do show at the top-line level the 10-year numbers, because we know it is expected, and we didn't want to obscure at all the difference between last year and this year. But we didn't waste our time or the reader's time with the rest of the budget. We stop at 5 years.

Ms. DUNN. Okay. Let me ask you one more question, because scoring has been a consistent problem. I have been working for years on trying to repeal the death tax. We have had many different scores. It is incredible how many different scores we have had on this. I applaud your effort, Mr. Daniels, to go for permanency in all the tax relief provisions that were signed by the President last June. I hope we can work toward that.

I did notice that there was a huge score on the repeal of the death tax. I think it was like $130 billion, far greater than I had ever seen before. And I wonder if you happen to know about that, where that came from, or if I can get some information on how that score was put together.

Mr. DANIELS. I would want to talk to the Treasury people who prepared that. I didn't notice that it was that big a discrepancy, but I would be happy to answer you quickly in the aftermath of the hearing on that.

Ms. DUNN. Okay. And let me just say that Mr. O'Neil suggested that when we do such scores, it might be wise to have a static score and a dynamic score for these items. I think that might be a way to go. What do you think about that?

Chairman THOMAS. I think the Director is mulling over that question.

Mr. DANIELS. Just making a note to myself.

Ms. DUNN. Do you think that would be a possibility of doing the two different sets of scores?

Mr. DANIELS. Again, I would want to talk to Treasury about it. If the Secretary thought it was a good idea, I suspect I will, too, but I would want to talk to him about it, and I would want to talk to the—our fellow scorekeepers and make sure that they thought it had integrity.

Ms. DUNN. Thank you.

Chairman THOMAS. Thank the gentlewoman. The gentleman from California, Mr. Becerra, wish to inquire?

Mr. BECERRA. Thank you, Mr. Chairman. Mr. Director, thank you very much for being here. I would like to just focus a little bit on where we are today given where we thought we would be a year ago. And I know that no one could have expected 9–11, and certainly we hope that we don't have to foresee anything like 9–11 again, and we will do everything we can to prepare ourselves to meet that risk. But it seems to me that much of what we did last year, this Congress did—because I did not support the tax cut—was predicated on those assumptions. And I know that the President, and you in many statements, made it very clear that you were trying to achieve certain goals.

The President had said back in his Joint Address to Congress in February of 2001, quote: "We owe it to our children and grandchildren to act now, and I hope you will join me to pay down $2 trillion in debt during the next 10 years. At the end of those 10 years we will have paid down all the debt that is available to retire."

Now, I understand that was a principal goal; and you indicated that back in March of 2001 you stated that a principal goal of this President and his budget is dramatic reduction of the national debt. I hope a goal universally shared, you said. The President's budget over the next 10 years will lead to an increase in the national debt, not a decrease and certainly not a dramatic decrease. Does that mean that the President has abandoned his goal at dramatic decrease if not elimination of the national debt as we know it?

Mr. DANIELS. No, not for a minute; and I—every word you read is as true today as it was then.

Let me say a couple of things. One is, the reason for my previous chart, we really don't know how many resources we will have. It depends entirely on economic growth, if it comes back, if it comes back perhaps more strongly than we can see in prospect right now. We have pretty conservative economics in our assumptions. No one would be happier than I or the President if we could pay the bills associated with defending our country, meeting our needs, and return quickly to paying down debt.

Mr. BECERRA. But this budget doesn't pay any of the national debt, does it?

Mr. DANIELS. Well, it would pay—yes, over the long term on these projections it would, but not what we are hoping to pay and still hope to pay.

Let me just point we could pay down debt in the year ahead of us in spite of everything, and I can show you that. This is the composition of the deficit——

Mr. BECERRA. I understand, but let me make sure. Our debt is what, somewhere around $3.5 trillion?

Mr. DANIELS. About $3.3 trillion right now. That is the publicly held debt.

Mr. BECERRA. Publicly held debt, putting aside Social Security, just the national debt as it set—the raw budget debt, $3.3 trillion. At the end of the 10 years under the President's budget, it is at least $3.3 trillion, is it not?

Mr. DANIELS. Actually, no. Again, on these numbers that the convention requires us to produce, we would still run after everything a trillion dollars of surplus over the timeframe. So it would come down but not nearly as far as we had hoped.

Mr. BECERRA. So then the numbers that you provided and CBO provided us are wrong because they say—those numbers say that the debt will be at least the $3.3 trillion that it is today?

Mr. DANIELS. Well, you don't know and I don't know and CBO doesn't know because——

Mr. BECERRA. Right. But we are doing things based on projections. We passed a tax cut bill last year where——

Mr. DANIELS. That is an interesting point, though. If you are, like I, a skeptic dubious about our long-term clairvoyance about these things, you probably ought to be feel good about the tax relief of last year, whether you liked it or didn't from this standpoint. It was more backloaded than the surpluses we hoped to see. Therefore, you have got many, many chances to revisit it if you think that is good policy.

Mr. BECERRA. I think what I hear you saying is, because of the hits, the costs of the tax cut last year won't hit for a few years. We may have a few years to prepare. But if the economy doesn't improve, those big hits are going to be pretty big hits. Let me ask——

Mr. DANIELS. Let me just say it is only a hit if you are sitting in Washington. If you are a parent who has a child, who would like a child deduction or if you are a married couple and would like to get out of the marriage penalty, if you are any taxpayer hoping for a little tax relief, you probably don't think of it as a hit.

Mr. BECERRA. Director, I would love to do that as well, but I would love to tell my parents that I won't be using their money for Social Security, and I would love to tell my children that I won't charge them because I am using the government credit card to pay for the debt that I incur today so that I can retire and then my kids will then have to pay for my retirement.

I want to strike on one last point and that is that in your budget, as much as we are going into deficit spending and because we are having to borrow money from Social Security, it seems to me unfortunate that the President's budget also cuts all the money from two particular programs that are so essential to so many places, especially Los Angeles where I am from, and that is school construction dollars and classroom size reduction dollars. I hope that the President will rethink that because certainly in places throughout the country we need to provide our kids with an opportunity to learn so they don't have to depend on government and can work and get this economy rolling again.

So, Mr. Chairman, I thank you for your time; and, Director, I thank you as well.

Mr. DANIELS. Thank you.

Chairman THOMAS. Did you want to briefly respond?

Mr. DANIELS. Oh, very brief.

Those two categories were hotly debated last year and didn't—and were I believe consolidated with other education activities by the Congress, and we did not—we agreed with that, by the way. We think that under more flexible—more of a block grant approach communities can make their own best decisions about whether they need—what they need most to improve their schools. So we did not seek to start up in this year's budget what Congress agreed to close out in last.

Mr. BECERRA. But——

Chairman THOMAS. The gentleman's time——

Mr. BECERRA. But, Mr. Chairman, just to clarify——

Chairman THOMAS. He answered the question.

Mr. BECERRA. Mr. Chairman, if I could just clarify the record, though. Those were programs that Congress agreed to pass back in the year 2000, and there was a commitment as a result of a compromise to fund that along with other education programs that Congress agreed to. So to kill the program is to go back on a commitment made—at least if Congress kills it, to go on back on a commitment this Congress made to fund school construction and classroom reduction.

Chairman THOMAS. Thank the gentleman. The gentleman from Georgia, Mr. Collins, wish to inquire?

Mr. COLLINS. Thank you, Mr. Chairman; and thank you, Mr. Daniels.

You know, you made a comment a while ago that you and the Administration, particularly the President, doesn't think that we are an undertaxed society. Well, I can assure you that the majority of the people in the Third District of Georgia don't think we are undertaxed. In fact, the majority of the people in the Third District of Georgia think that we overspend and that is the real problem in this town.

Now, having said that, the real problem, too, is that we have a tendency with the party that is in majority, no matter which one it is, and today we have both on each end of the hall, a separate majority, we have a tendency to enhance programs and enhance spending which just creates more problem with the fact of taxation. And until we can control our spending habits, we will have a hard time controlling the tax problem that we face.

I was reading a quote the other day from the Chairman of the Federal Reserve when he testified before this Committee a year or so ago when asked about taxation. His response was, the lower the tax, the better. He has always been an advocate for reduction in marginal rates and for reduction in capital gains because he felt like, if you could reduce those, those were the incentives for people to enhance their income and to better their position, which also enhanced the Treasury of the United States.

Last year when this same gentleman testified before the Budget Committee, he was asked the question, do you think you raised interest rates too quick and too high? Of course, naturally, he said no. His goal in doing so was to slow down corporate capital investment. He was successful, very successful. In fact, today, after reducing the interest rates 11 times, which I think is a record number of reductions, Mr. Greenspan says that the problem today is a lack of capital investment because capital investments are what create jobs. It is marketplace activity. It is people buying what comes off of an assembly line or else it is purchasing or constructing which entails jobs.

So I think to even think about going back and reviewing or putting back on the table and reversing the trend of reducing the marginal rates would be entirely wrong, and I think for anyone in this town who thinks that the problem with unemployment is insufficient unemployment benefits or insurance are just plain-out dumb. The problem with unemployment is the lack of a job, and there are things that we could be doing, things that this body has done, this Committee has done, and the things that the President has promoted that would encourage investment and create jobs.

I hope that those who seek to use this situation of unemployment, recession, war and emergency as an enhancement to their political progress in November of this year fall flat on their face, particularly by stopping and obstructing things that will help citizenry at home.

I said yesterday and I will say it today and I will say it tomorrow, the problem in this town is we focus on the cash flow of the Treasury instead of the cash flow of individuals in business where the cash flow of the Treasury comes from. Until we change our view and support our constituency and their livelihood, we are just absolutely off base; and to think that we continue to put in place programs that increase the number of people who are dependent upon the government is going to help this Republic to stand too are dumb, because that is what leads to the demise of a democracy or this Republic. Because the definition of such is, once—the definition of a democracy is, once people learn of the benefits that they can receive from this Treasury, they elect people who will enhance those benefits and leads to the demise of the democracy which will be the end of our Republic. That is not doom and gloom. That is truth.

I hope that the President will hold the line on spending more so than we have on this budget. I hope that the President will take a look at measures and issues that are being presented or will be presented that transfer more payments of one taxpayer to another, because that is wrong. Thank you, Mr. Daniels.

Mr. DANIELS. Thank you, sir.

Chairman THOMAS. Thank the gentleman from Georgia. The gentlewoman from Florida wish to inquire?

Mrs. THURMAN. Thank you, Mr. Chairman. Welcome, Mr. Director. Glad to have you here.

Mr. DANIELS. Thank you.

Mrs. THURMAN. I want to go back in history a little bit, because I am very concerned that we are kind of doing a deja vu here and just kind of remind us of what happened in—first in 1981, when the Reagan tax cut came in. And it was done. I wasn't here at the time but remember it.

Then I have had some conversations with people over the years to see what happened after 1981 and actually have pulled together kind of a list of things that did take place; and, by the way, they were revenue—trying to raise revenue after the 1981—so we had things like the Tax Equity and Fiscal Responsibility Act. We did the Highway Revenue Act of 1982. Then we did the Social Security amendments of 1983. If I am correct, that might have been the time that we first taxed Social Security at 50 percent.

Then there is—we go on, and we have budget reconciliation and omnibus budget reconciliation, all of which were revenue raisers because of what happened under the 1981—and if I remember correctly, Senator Dole was one of the architects of that.

Then I know recently when we have had some of the Social Security debate, we had Senator Dole come in and talk to us about what happened in the Commission in 1986, and in fact we had to raise the retirement time for somebody to retire. I believe payroll taxes were increased.

Then in 1990 we had another revenue raiser because we were also in some problems of deficits. Then in 1993 we all know we came in and we did it again; and at that time we also put another 30 percent, raised the rates on Social Security, put those dollars in the Medicare trust fund.

Then in 1997 we did the Balanced Budget Act, which, by the way, we cut millions—actually, billions of dollars out of Medicare.

So part of my concern is that I see kind of this pattern that potentially happens, and that is when we start doing some of these tax cuts, some of which have not given us exactly what we thought it was going to do to the economy, and it has created some deficits in some of our social programs such as Social Security and Medicare. Those two programs are the ones that end up having to have changes and are targeted for changes so that we keep them solvent.

Well, we thought we were doing pretty good because by 2000—you know, we moved out that Medicare solvency was going to 2025, Social Security was going to go out to 2039. I am very concerned, and I know we don't have those numbers yet, at what the actuaries are going to show when we come back in here as to solvency of those two, at what age or what date the solvency of those two trust funds are going to be as compared to where we are today and what kinds of potential concerns or changes we might have in these programs.

We had Secretary Thompson in here this morning. I had several questions because, obviously, I am from Florida. As you can imagine, Medicare is a huge issue for us. But we had several questions of what was going to happen in nursing homes, about 17 percent cuts that are a very big concern to them and are very unstable. Government pays for about three to four—three out of every four beds.

It looks to me like the prescription drug benefit potentially is being shifted down to the States through their Medicaid program basically or at least some standards set for them to be able to do this, maybe covering over about 3 million people in the country.

But, you know, it is nice to hear about all of this, but there are people that have offered some alternatives like the trigger. I understand Ellen Tauscher offered that in the Rules Committee yesterday or last night to try to fix some of this.

So I guess, Mr. Director, what I am really trying to get at, if in fact—because we have all said the assumptions didn't work. They have done this. They have done that. We couldn't rely on them. You know, things have changed. We had a recession. We had the terrorist attacks. We have all these things going on. What is your plan based on knowing that we have got that bloated tax cut? If these things don't work, if this economic package that you are trying to do, what hope can you give to the American people that you are willing to come in and make some of those tough issues and tough ideas that might have to be presented without continuing to touch the same programs that have been cut over the last several years, being Social Security and Medicare?

Mr. DANIELS. Well, thank you, Congresswoman. You raised a lot of important points, and I am going to try to center on what I think was the core of your question.

The first thing to say is that surpluses are a very important goal. They are not the end of government. In fact, they are not—they are at least behind three other objectives, all of which, through circumstances nobody here created, the President didn't create, we are confronting simultaneously.

So the first thing I think to say to you is that, as important as they are and as much as we want to get back to them quickly, there are some things that come first. They are the defense of the American people, their safety, their physical safety, the first and foremost responsibility of the central government ahead of everything else. Then the encouragement through the things government can do which is not—it is not all powerful in the economic area but the things that it can do to encourage a return of economic growth. And it is only economic growth that will create surpluses.

Your history catalogue was important, I thought, and useful, but I am pointing out that it is really economic growth that gets us to a strong position, not the other way around. Surpluses have never created a job or a higher GDP.

I think that the—you ask about tough decisions, and you have a President who I think has proven he doesn't shrink from them, and he has made a few already. He will make some more. He will make some in the arena we are talking about now.

I was encouraged by Congressman Collins' suggestion that we look even harder for modifications in the budget that might bring balance back to us more quickly.

Finally, I would just say that one thing many of these questions I think point us to is the need to get serious quickly about Medicare reform. This budget asks for it. Again, the President has asked for it since coming to office. We ought to move to it quickly.

Anything we do with regard to prescription drugs for the most vulnerable elderly ought to be a mere bridge as short as possible, a transition to genuine Medicare reform, and that is the single most important thing we can do to offer long-term hope both for solvency and for better quality. And both the programs that you mentioned that we all treasure, these programs are both in need of long—comprehensive reform, and let us get on with it.

Chairman THOMAS. Thank you, Director.

I tell the Members, to the degree their questions consume the 5 minutes, there will be no response. The Chair has tried to accommodate moving down the lower level. The last two inquirers have consumed almost 10 minutes each. It makes it very difficult to accommodate the Members' wishes. When they are allowed to do it, they then extend the time the way they have and a significant discourtesy to others.

The gentleman from Ohio wish to be recognized?

Mr. PORTMAN. Thank you, Mr. Chairman; and thank you, Mr. Director, for being here.

We were talking about history, and I just thought it would be helpful to talk about history and ask you a few questions, first of all, as to whether we are overtaxed or undertaxed? As a percentage of our income, are we taxed at rates that have been historically on average or are we high or low?

Mr. DANIELS. Well, above average, Congressman. This is after the tax relief and throughout the horizon we can see and at all-time record levels when we look at individual income taxes.

Mr. PORTMAN. In fact, the 18 percent average over time is going to be exceeded even after the Bush tax cuts are all in place?

Mr. DANIELS. It is being exceeded right now and will be as far as we can see——

Mr. PORTMAN. The highest tax rates except during war time.

Second, with regard to the debt and deficit, just interesting statistics out there on that, a lot of concern about the debt now. We pay down almost a half trillion dollars on the debt. We want to pay down more. But as a percentage of our GDP or of our economy or as a percentage of outlays, how does our debt compare to the last 20 or 30 years?

Mr. DANIELS. Down substantially, much, much lower than all the other developed countries. This is not to say that anybody is satisfied with it, only to try to keep it in perspective.

Mr. PORTMAN. We are down to a percentage of what we were in 1970s now, and that is thanks to economic growth and beginning to curb the increase in the debt. As far as the deficit goes, have we ever not run a deficit during a recession?

Mr. DANIELS. Not to my knowledge, sir.

Mr. PORTMAN. Does your budget propose a deficit that is about what it has been during a typical recession or is it a lower deficit?

Mr. DANIELS. Actually, somewhat smaller; and, again, this is not to express any satisfaction with any red ink at all——

Mr. PORTMAN. But it is an important question to remind during recession——

Mr. DANIELS. Yeah, the deficit one on the right, as you can see, the one we are in now, the smallest reaching all the way back to World War II——

Mr. PORTMAN. Another historical issue that has been talked about a lot is tax cuts, and I just think it is interesting when you look at where we are. We have got a recession. We have a war. We have a national emergency. Yes, we put some tax cuts in place which hopefully will have kept the recession from being worse than it would have been, will keep us from going into a deeper recession.

As I recall, the Democrats have an alternative on the tax cut in the Senate. It was a cost that was $1.25 trillion versus the Bush tax cut which was $1.349 trillion. They had virtually the same cost. Would it have had the same impact on the surplus?

Mr. DANIELS. Yes, and some of the alternatives would have had a more severe impact on the near term, that is, this year and next year; and the ones we are looking at in this budget actually would have been—would have—the deficits would have been deeper under those alternatives.

Mr. PORTMAN. I think it just gives us some historical perspective with regard to taxation, with regard to deficits and debt, and with regard to tax policy and its impact on the budget.

The final question I have for you, I notice in your budget that you have got the refundable health care tax credit. I didn't have a chance to ask Secretary Thompson about it this morning. I wonder if you can give me your personal views on that and how do you think it would impact the uninsured?

Mr. DANIELS. The President believes it is a very important initiative and hopes that Congress will treat it promptly and seriously. We are doing all we can right now to—and Secretary Thompson's in the lead in trying to extend coverage to the uninsured. We are using much broader use of the waiver policy under Medicaid to do that. A million and a half people have secured health insurance in the last year through that device, but this would reach, of course, millions more in a direct way, in a way that gives them the choice, gives them autonomy and dignity in meeting their own health care needs, and we would very much like to see it. We wanted to see it for dislocated workers in the stimulus package that this body passed, and we would like to see it on a permanent basis.

Mr. PORTMAN. We are encouraged to see it in the budget, and I thank you, Mr. Director.

Mr. DANIELS. Thank you.

Chairman THOMAS. The Chair would inquire then of the Director, would it be possible to get some signal from the Administration or preferably the President that if in fact the Senate sends over an unemployment insurance package as the single response in this time of need that there might be a signal that perhaps the displaced workers' tax credit or a more broadly based tax credit could be attached to the UI and perhaps the New York package to make it a bit broader based?

Mr. DANIELS. Well, the answer would be perhaps. I will be happy to take that idea back.

Chairman THOMAS. Thank you for the "perhaps." The gentleman from Texas wish to inquire?

Mr. DOGGETT. Thank you. Mr. Daniels, I want to thank you again for the very constructive role that you played in the airline bailout. There was some of my——

Mr. DANIELS. Yes. Rescue.

Mr. DOGGETT. Some of my colleagues that wanted to write essentially a blank check to Continental Airlines and some of the other airlines, and after my objection I think your personal involvement and your office's involvement were important in getting some safeguards in place to protect the taxpayer, maybe not every one that I wanted, but I think it was an important step forward.

On the other hand, I have been concerned about some of the things you have said about the statutory debt ceiling. What do you believe is the amount of the increase that the Congress needs to approve in the debt ceiling and what is the final date by which we need to do it?

Mr. DANIELS. I take my cue from the Secretary of the Treasury here, but I believe the correct answer is $750 billion and—during March to be safe in terms of keeping the operations of government moving uninterrupted.

Mr. DOGGETT. Under the plan you have laid out here over the next 10 years, that won't be the last time that we will need to raise the debt ceiling, will it?

Mr. DANIELS. I wouldn't say we would be planning for more. Again, I have every hope and will take every step to see that we get back to surplus as soon as we can. But you are correct. On the projections here, this would not be the last time.

Mr. DOGGETT. I don't see anything in your budget to cover what I assume is still an objective of the President to privatize Social Security with the individual accounts. As you know, the Deputy Actuary of the Social Security Administration has made some projections about transition costs, and while I understand the goal is to not offer the privatization plan until after the election, I think everyone involved recognizes that there are hundreds of billions of dollars in transition costs and yet there is not anything in your budget to cover that, is there?

Mr. DANIELS. Not specifically, sir. I think privatization is probably not the right word to describe where we are. Clearly, the President does favor as a part of the future retirees' options the option of some personally directed investment accounts, but——

Mr. DOGGETT. I understand——

Mr. DANIELS. Usually people mean something more by "privatization."

Mr. DOGGETT. You use different terminology.

Mr. DANIELS. Right.

Mr. DOGGETT. But whatever the terminology is, private accounts or privatization, the cost of transition is not inconsiderable, is it?

Mr. DANIELS. Yes. The Commission has, as you know, laid out a series of options, none of which has been settled on yet. Clearly, this is going to be an extended conversation. There are many people who favor different of those options, some who disagree with all of them, and therefore we didn't feel it was timely to pick a number which could vary dramatically depending on which outcome we have.

Mr. DOGGETT. But as we look over the next 10 years and whether to provide—as your budget does propose an additional $650 billion in tax cuts plus whatever we might do on AMT relief or expiring tax credits, it is certainly appropriate for us to consider what the costs would be for any transition to private accounts, isn't it?

Mr. DANIELS. I would not disagree.

Mr. DOGGETT. I like your idea of a management scorecard and performance budgeting, but I note that one of the several agencies that failed in all five categories was the Department of Defense, and they are getting the biggest increase. It seems to me that when you look at the reports that the General Accounting Office, that the Inspector General of the Department of Defense have done themselves concerning waste and mismanagement at the Department of Defense that our security is not improved with more waste and mismanagement, and I hope your office will be giving consideration to what can be done, whatever the funding level is. We don't get the most security with the most waste, but we seem to be adding there.

Then, finally, we had the cameo appearance from Secretary Thompson here this morning on prescription drugs. I know, having worked before coming to this office for Eli Lilly, you are very familiar with this area, but it does seem to me that the prescription drug program that this budget contemplates is not one that is going to do much for very many seniors and that unless we use—and I know this is contrary to the pharmaceutical manufacturer's position—unless we use the bargaining power of the Federal Government much as we have done for our Nation's veterans, appropriately, to try to help them negotiate lower prices, that our seniors are going to continue to face the highest prices in the entire world for their prescriptions if they are uninsured; and I view this as a serious deficiency in the budget.

Beyond that, the concern that I have is that when you take what is essentially $2 trillion of money that was paid in—even though you credit it to Social Security and Medicare trust funds, it was paid in for that purpose in payroll taxes—and use it for non-Social Security purposes and non-Medicare purposes, it really is a raid on those funds.

Mr. DANIELS. Two quick responses, if I may, Mr. Chairman.

First of all, Congressman, much in there I agree with. Let me just make a point or two. We always use Social Security for other purposes. What we use it for when we can is to pay down debt. I think that is everyone's preferred use, but it is always used, and the trust funds are always just as big as they would have been. So in this era when we are at war at least temporarily, we find it necessary to use them for a different purpose, but it is important for folks to understand that they are always put to one use or another.

A quick word on prescription drugs. You made a couple real important points. I mean, to me we would not disagree that the steps the President has been pushing for, the discount card, the immediate help for those at the most vulnerable income level, are too partial and should be temporary. I mean, to—I think to the President the lesson is, let us get the comprehensive reform including prescription drug coverage for all as soon as we can.

Second, I would tell you that elsewhere in our budget there is a substantial increase—just on the point about the manufacturers' participation, a substantial increase anticipated in rebates that they pay through Medicaid. And this may not meet with favor there, but it is one of the ways in which we are trying to enhance and protect Medicaid patients.

Chairman THOMAS. The gentleman from Texas, Mr. Brady, wish to inquire?

Mr. BRADY. Yes, Mr. Chairman.

Mr. Director, the charts we have seen, the budget projections, surplus and all, those aren't written in stone, are they, for the next 10 years?

Mr. DANIELS. No, sir. That has been one of the—in fact, one of the charts sort of goes to that point. We really—it is hard to know. We can't know.

Mr. BRADY. But the single greatest way that we can return to large surpluses, paying down the debt and creating more revenue for Social Security and Medicare, isn't the greatest single thing Congress can do right now is to get the economy moving as soon as possible?

Mr. DANIELS. Yes, no question.

Mr. BRADY. So would it be your opinion that at this point in the recession and if we really are concerned about balancing the budget and paying down debt and preserving Social Security, neither Chamber in Congress ought to give up on getting this economy moving now; is that right?

Mr. DANIELS. That would certainly be the President's point of view.

Mr. BRADY. I appreciate, too, your focus on results rather than just activity. Up here it seems we always measure our progress by how much more money we pour into a leaky bucket. We rarely work on fixing those leaks and trying to actually get that service to the people who most need it and to that direct——

I serve as a new Member on the Social Security Subcommittee, and I am dealing with disability issues where we have got retirement claims. Disability claims are projected to jump by more than half, and so funding for Social Security is reaching the Administration—reaching critical stage.

The bipartisan Social Security Advisory Board has repeatedly said we are going to need new resources, greater productivity, especially since about half of our employees are ready to reach retirement soon, and we have an increased backlog. We have got about—in disability we have got almost 1.2 million individuals whose claims are backlogged, and in my Houston area it has really reached a critical stage. We have one of the longest wait times in the Nation for a hearing just before a judge, and if you are caught up in this backlog, it really is a terrible situation to be in.

Two questions I have. We all agree we need good service delivery. What can be done, do you think, in the near term to ensure the Social Security Administration does a better job getting the disability benefits to those who need them in a fair and efficient manner?

Second, how do we start now from a resource and productivity perspective to set the agenda so we can effectively deliver these services long term?

Mr. DANIELS. That is a very important question. I met with the new Commissioner of Social Security pretty shortly after her appointment. This was the first item on her agenda.

We talked about it. We talked about the resources required but also about potential reorganization or efficiency improvements at her department that might begin to bring that backlog down; and I can assure you, when you have her before you, you will find she sees it as job one.

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

Chairman THOMAS. Thank the gentleman. The gentleman from Louisiana wish to inquire?

Mr. MCCRERY. Yes, Mr. Chairman, thank you.

Just in case you are wondering, Mr. Daniels, those of us on the top row here have not been ignoring you. We have allowed our colleagues below us on the Committee to ask questions first since we were allowed to ask questions first this morning with Secretary Thompson. So I am delighted to have you here and to be able to talk with you about the budget.

I might just say on the repeal of the corporate AMT, when the President originally announced his intention to have us move an economic stimulus package, he did request repeal of the corporate AMT. Now, he did not request the redemption—immediate redemption of the credits. We came up with that on our own. It was a good idea then. It is still a good idea in terms of stimulus, if that is what you want, because it pushes about $21 billion out the door in the first year, and it doesn't cost a dime over 10 years because the Joint Committee on Taxation assumes that those corporations would have redeemed these credits in any event over the next 10 years. It is their money.

Now, of course, in your budget you say reform the corporate alternative minimum tax, I assume somewhere along the lines that we included in the negotiation with the so-called centrists in the Senate in a second package that we passed as a result of those negotiations.

Thank you very much for including in the budget a proposal for reforming our unemployment insurance system. It is very badly needed, particularly in light of welfare reform, our emphasis on work and getting people off welfare into the workforce and particularly in light of our renewed familiarity with economic cycles and knowing that we can have recession still, and there is a need for employment services. That need has gone sorely lacking because of Congress' inattention to the matter and appropriating less money to the States than they need to adequately run their unemployment insurance services, including unemployment services. So that was a welcomed addition to the budget, and I look forward to working with you and the Secretary of Labor on implementing that.

There has been a lot of talk this afternoon about the budget, the debt, the deficit. Generally, Mr. Daniels, would you agree that our economy and our fiscal situation at the Federal level are fundamentally strong still, that we are in better shape now than we have been in a long time in terms of our economy, the underlying fundamentals of our economy and the budget or the Foreign Sales Corporation of the Federal Government?

Mr. DANIELS. Yes, sir, I would. I think that it is a tribute to people on both sides of the aisle and this Administration and previous ones that we found ourselves in this position again. I think it is historically striking that in a recession with a war and with some emergency costs from last September's attacks all rolled up simultaneously that we are essentially at balance on an operating basis, as I pointed out. Until you take the additional step, as the President would much like to do, of attacking the recession further with a stimulus package you are about in balance; and in historical perspective that is astonishing.

Mr. MCCRERY. So, in other words, citizens of our country, even though we are in a recession and even though we have challenges from a security standpoint, in terms of our economy, in terms of our financial condition, they ought to be comforted that we are still in good shape.

You say in your testimony that we will pay 9 cents of every dollar as interest payments. You don't say when, though. When under your budget are we scheduled to reach that level of nine cents of every dollar for interest payments?

Mr. DANIELS. We are there. It is about 8.7 cents in the year we proposed, as I recall, fiscal year 2003; and it has been coming down rather rapidly. Again, we can't go low enough I suppose is the way we ought to all agree to look at it, but we ought to recognize where it is.

There is a chart I can show you that does remind us that not too long ago much more of that money—we were correctly reminded by a question over here that money is not particularly productive, but this is the burden on the Federal budget, and you can see just as recently as a few years ago it was almost twice the level we will now be at.

Mr. MCCRERY. So, in other words, for 2003 you are projecting 9 cents on the dollar for servicing the debt?

Mr. DANIELS. Yes, sir. Just a little less.

Mr. MCCRERY. Great. Thank you very much, Mr. Chairman, for allowing us to visit with the Director; and thank you, Mr. Daniels.

Mr. DANIELS. Thank you.

Mr. MCCRERY. Keep up the good work.

Chairman THOMAS. The Chair appreciates the line of comment because, frankly, a dropping deficit in an environment of an increasing GDP means you are managing the deficit in a way that none of us thought. Some of us remember just a short time ago that the interest on the national debt was the third largest payment that the Federal Government made, notwithstanding the circumstances we are in. We have a much brighter picture than we did just a short time away.

The gentleman from North Dakota, by gosh, wants to be recognized.

Mr. POMEROY. North, by gosh, Dakota. Mr. Chairman, thank you very much for calling on me, and I am delighted to have the chance to ask some questions of the Director.

First, I would note that it appears, using the Administration's numbers, the actual borrowing cost would be a trillion dollars more in light of the additional debt, rather than if we had been able to keep on the debt reduction timeline that the Administration projected 1 year ago.

My question gets to—the first part of my question gets to Veterans Affairs (VA) and funding for veterans' health benefits. The President specifically noted in his State of the Union a historic increase in commitment of resources to veterans' health. Seven percent growth I believe is what it would equate on a percentage basis. Put in perspective, however, that is a little less sufficient than one might otherwise think.

Two reasons. Health inflation, which is about 11 percent, costs going up at 11 percent. Anyone who has paid a health insurance premium increase knows that costs aren't holding level, they are going up, and they are going up beyond the 7 percent range, again about 11 percent nationally.

Also, however, when you are looking at the veterans population, you are looking at the World War II vets, you are looking at the Korean vets, and you are looking at utilization increasing as these aging veterans require more health services than they did previously in their younger years, 11 percent increases in utilization, I believe what the VA figures show. So you have got utilization going up by a rate of 11 percent, you have got costs going up by a rate of 11 percent, and you have got a commitment for the budget of a 7-percent increase.

Now, the resulting bind has had some terribly unfortunate consequences. Recently in North Dakota I have had some meetings on veterans' health care, heard horrifying stories about newly qualifying veterans, senior citizen veterans waiting 6, 8 months before they can access their initial visit to the doctor.

Even worse than that, the region that North Dakota is in for veterans' health care has literally closed down the satellite-based outpatient clinics to any new patients. A veteran in Minot, North Dakota, for example, that happened to be an existing patient will have health care available through the VA satellite facility in Minot. Someone that is just now requiring services is going to have to drive to Fargo, North Dakota, a drive of about 7 hours, to access those services. That is a very, in my opinion, insufficient way to address cost response problems.

I am wondering if the Director has a response in this area.

Mr. DANIELS. I would start by saying that the increases last year and then again especially this year, that you just correctly referenced will be up over $26 billion in the VA this year, is evidence of the commitment that the President feels at a time of war when, as I say, the average for nonwar-fighting activities is two. One way to look at this is it is three and a half times the rate of increase being provided here. I think that is worth recognizing at the start.

In terms of health cost inflation, it depends which part of health care you are looking at. The VA system in general is a pretty good one and has done some very innovative things to—such as bulk purchasing of pharmaceuticals, which was mentioned a minute ago, that have kept its costs somewhat more in line.

I think you are quite right that the big driver over there is not unit cost inflation as much as it is utilization. Part of that is demography. Part of that has been the broadening, you know, dramatic broadening in who is eligible, so-called category 7 vets, higher income and nondisabled now eligible or driving—they are going—they have gone from something like 4 percent to 21 percent of all utilization. That is the big increase that Secretary Principi is wrestling with, and it is worth keeping our eye on.

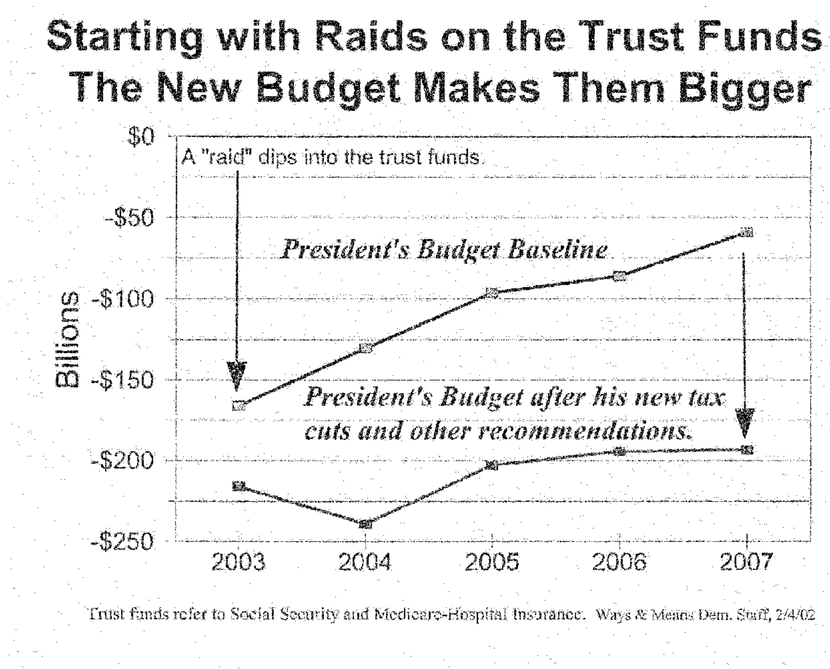
I made careful note of the fact that you have—that there are some local problems that you have seen, and I will make sure to report those. My sense is that—and I hope this is true that they are somewhat exceptional. It is harder to deliver service of VA-type quality in sparsely populated areas, but I am sure that Secretary Principi will not be happy about it and will want to do something about it.

Mr. POMEROY. I have spoken with the Secretary and will be meeting with him later this month. I thank you, Mr. Director, for that.

It is just not acceptable to try and work your way through the budget shortfall by creating identically placed veterans in the same community with a very dramatically different access to health services.

Finally, the last question I would have is relative to the budget itself. We are looking at deficits. I am interested in your comments about pulling out of deficits in the near future. We have a chart that indicates, and I have made copies for the Members, that basically within the President's budget proposal the additional tax cut would take us from a deficit position to a deeper deficit position and that indeed the general fund never does get out of deficit for the entire run of the next 10 years, which means we are subsidizing functions of government with revenues coming in for Social Security or Medicare.

[The chart follows:]



Mr. DANIELS. Of course, you are using your definition. Instead of unified budget, you are using the on budget, that is, taking the trust funds aside, which is a concept we understand. I point out there has never been a period in our history where we ran an on-budget surplus for an extended period. We agree with you we would like to do it. It all depends on the economy.

It is worth noting that this year and next year the same, if there had never been a tax relief bill and in fact if we had not spent a nickel more than the year before, the economy alone would have, quote, raided Social Security, would have, quote, broken the lockbox all by itself by a large amount in the year we are sitting in. So that is—as others' questions pointed us to, that is the key variable. That is what we have got to look at.

If it does come back, our long-term outlook could brighten once again. Two years ago today, we saw $2.9 trillion over 10 years. Everybody said hooray. That was the best we had ever seen. Last year, it looked much better. This year, we are back where we were in 1999. I hope we go back up.

Mr. POMEROY. Mr. Director, your own comments of a year ago, having protected every penny of Social Security, every penny of Medicare receipts for Medicare, setting aside $1 trillion for needs and contingencies, it is still a $1.6 trillion overcharge to the American taxpayers. That was not a qualified outlook you placed on budget projections last year. You indeed were perhaps the loudest voice for these are projections we can bank on. We did with the tax plan, and now we have got a decade of deficits as a result.

Mr. DANIELS. Well, I beg to differ. I would be happy to send you a list of many, many times, including I will bet you on the very day that—February 25 there in which I talked about the uncertainty of the long term. The reason that we talked about a $1 trillion set-aside contingency, the explicit reason was because we cannot know the future.

Now, looking from today with everything that has happened, it is true that $1 trillion was—even $1 trillion wasn't enough. The shortfall just from the economy was in excess of that, and for that I have no particular defense except it is not as though we didn't think of the very real possibility that circumstances could work against us.

Mr. POMEROY. But knowing what—I thank the Chairman. Thank you, Mr. Director.

Chairman THOMAS. Let the Chair respond to the gentleman's concern about the veterans who have to drive 7 hours to Fargo. I just tell the Director, we have been trying to work—and we came close in the last Administration—with the concept in terms of distances where you have a VA without walls. You really only need a storefront with a computer in which the veteran is determined and you contract in the community.

It makes no sense with the World War II veterans now in their seventies having to get outpatient services and drugs filled and other very modest treatments to require them to go to the bricks and mortars owned by the U.S. Government with the VA title on it. This really is a way to make sure that they get the kinds of services that they are entitled to, instead of having an administrative structure which is somehow hooked to bricks and mortars being serviced to our veterans. This idea of simply contracting where there is not going to be a VA health clinic or even where there is one, for example, in my district where they have cut back significantly on the benefits, means why don't we just let the veterans get the services in the areas where they reside and contracting out the local services? The service, the commitment to the veteran is what we ought to honor.

Mr. DANIELS. Right.

Chairman THOMAS. Not a requirement that they visit some particular building.

Mr. DANIELS. That is absolutely right. A lot has been done. Much more needs to be done in contracting out.

I will just add one other footnote. It will help if we can continue to have support in Congress for getting out of bricks and mortar that we really don't need anymore. There are many places in America—while you don't have enough facilities in Minot, there are places where we have multiple hospitals within blocks of each other and don't need them, and we do have difficulty sometimes moving to where the need is.

Chairman THOMAS. Any additional questions?

The Chair and the Members would thank you very much, Mr. Director, and look forward to the difficult decisions you have, especially the responses to the particular questions that have been asked.

The hearing stands adjourned.

[Whereupon, at 4:05 p.m., the hearing was adjourned.]

[Questions submitted from Chairman Thomas and Mrs. Johnson to Mr. Thompson and Mr. Daniels, and their responses follow:]

U.S. House of Representatives
Washington, DC 20515
February 8, 2002

The Honorable Tommy Thompson
Secretary
U.S. Department of Health and Human Services
200 Independence Avenue, SW
Washington, DC 20201

The Honorable Mitchell E. Daniels
Director
Office of Management and Budget
725 17th Street, NW
Washington, DC 20503

Dear Secretary Thompson and Director Daniels:

Thank you for testifying at the Ways and Means Committee this week. We appreciate your hard work in developing the President's budget in this difficult time for our Nation.

As we stated in the hearings, we commend the President for not reducing the resources he devoted to prescription drugs and Medicare modernization last year, notwithstanding the new realities of the war on terrorism and an economic downturn, which has produced short-term budget deficits. We share your commitment to ensuring that our seniors and disabled beneficiaries receive the highest quality of care for a price our taxpayers can afford.

The President's budget provides $190 billion over 10 years for prescription drugs and Medicare modernization, of which $77 billion is reserved for low-income drug assistance. The budget proposes spending increases for private plans in Medicare of $4.1 billion. It also proposes several modest savings proposals—competitive bidding for durable medical equipment, Medigap reform, Medicare Secondary Payer and Graduate Medical Education reform—which collectively total $6.5 billion. Hence, there is $116 billion remaining for prescription drugs for all non-low income beneficiaries and Medicare modernization. Although we believe $116 billion is insufficient for a comprehensive prescription drug benefit, we assume you share our belief that none of this money is intended for provider payment increases.

The Administration's budget includes a statement that any provider payment adjustments must be budget neutral in both the short and long-term. However, the Medicare Payment Advisory Commission (MedPAC), a non-partisan advisory Committee of Medicare experts, recently recommended provider payment changes that could collectively total more than $174 billion over 10 years. The MedPAC recommendation for reforming the physician sustainable growth rate alone would cost $128 billion according to the CMS actuary. Clearly, we are not suggesting that we could afford, or that we should implement every MedPAC recommendation. However, MedPAC has identified serious problems, such as significant and successive payment cuts to physicians, which are unsustainable and require reform.

Does the Administration believe Congress should address any of the problems identified by the MedPAC (see attached list) with respect to hospitals, home health agencies, physicians, skilled nursing facilities and dialysis facilities? Please identify which provider problems you believe merit Congressional action and which do not. Since the budget calls for budget neutral payment adjustments, please provide a specific list of Medicare savings recommendations, which can finance appropriate provider payment changes.

Given the short legislative year, and our intention to act on Medicare legislation this spring, we would appreciate a prompt and detailed response to these requests.

Best regards,

Bill Thomas
Chairman
Committee on Ways and Means

Nancy L. Johnson
Chairman, Subcommittee on Health
Committee on Ways and Means

Enclosure: MedPAC Recommendations

WMT/NLJ/jm

Medicare Payment Advisory Commission Recommendations	**10 yrs. Billions**
Physicians	
• The Congress should repeal the sustainable growth rate and replace it with the Medicare Economic Index. The Secretary should revise the physician productivity offset from −1.5% to −0.5% to reflect the productivity of all costs rather than just labor. The resulting update for 2003 is 2.5%.	$127.7 [1]
Hospitals	
• The Congress should phase out the difference in the inpatient national rates between hospitals in MSAs >1 million and hospitals in all other areas starting in 2003. In the first year, the update for hospitals in MSAs <1 million and rural areas should be increased 0.55%.	$15 *
Rural Hospitals	
• The Congress should revise the Medicare Disproportionate Share payment formulas so that the payments for rural and small urban hospitals are capped at 10% rather than 5.25%.	$1.8 [2]
Skilled Nursing Facilities	
• If refinement of skilled nursing payment system is adopted by the Secretary as planned, Congress should fold-in the resource utilization group (RUG) add-on payments into the skilled nursing rates.	$10 [3]
Home Health Agencies	
• The Congress should update home health payments by market basket for FY 2003. (Current law is mb −1.1%.) The Congress should retain the 10% bonus payments for rural home health agencies.	$2 *
• The Congress should eliminate the 15% adjustment to home health payments, which otherwise would result in a 4% to 7% reduction in payments.	$17 [4]
Dialysis Facilities	
• The Congress should update dialysis payments by 2.4% in 2003.	$0.5 *
TOTAL	**$174**

[1] Office of the Actuary, Centers for Medicare and Medicaid Services (CMS), February 7, 2002.
[2] Medicare Payment Advisory Commission, February 7, 2002.
[3] CMS, Health Care Industry Market Update, February 6, 2002.
[4] Congressional Budget Office (CBO), January 2002.
* Estimates based on BBRA, BIPA and discussions with CBO, February 6, 2002.

U.S. Department of Health and Human Services
Washington, DC 20201
March 14, 2002

The Honorable Bill Thomas
Chairman
Committee on Ways and Means
U.S. House of Representatives
Washington, DC 20515

The Honorable Nancy L. Johnson
Chairman
Subcommittee on Health
Committee on Ways and Means
U.S. House of Representatives
Washington, DC 20515

Dear Chairman Thomas and Chairman Johnson:

Thank you for your letter to the two of us regarding the President's budget and the ways Congress could adjust Medicare payments to health care providers in a budget-neutral fashion. We know you share the Administration's dedication to better meeting the health care needs of elderly and disabled Americans, and appreciate your longstanding interest in and untiring dedication to these important issues.

President Bush believes that the Nation has a moral obligation to fulfill Medicare's promise of health care for America's seniors and people with disabilities. Medicare has provided this security to millions of Americans since 1965. However, as Medicare's lack of prescription drug coverage demonstrates, Medicare is not keeping up with rapid changes in the way health care is delivered or with benefits available in the private health insurance market.

To ensure that Medicare continues to provide our Nation's elderly and disabled secure access to modern health care, the President's Fiscal Year (FY) 2003 Budget renews his commitment to comprehensive Medicare modernization with integrated prescription drug coverage. His proposal is based on the framework for bipartisan legislation that he proposed in July 2001. Specifically, the President's budget proposes to invest $190 billion in Medicare to modernize the program by improving health insurance plan options that include prescription drug coverage. We agree with you completely that all of the new funding should be used for the President's top priority of improving the coverage options available to beneficiaries, including prescription drugs, and not for increasing payments to fee-for-service Medicare providers.

The President's top three goals for improving Medicare include quickly phasing in assistance with drug costs for Medicare beneficiaries, sustaining and enhancing the options available to beneficiaries in Medicare+Choice, and strengthening and modernizing the Medicare Program. This includes transitioning low-income prescription drug assistance into a drug benefit that serves all Medicare beneficiaries and adding new plan options for beneficiaries and updating the benefit package. Many of these improvements, such as full implementation of a prescription drug benefit, will take several years to set up. The needed improvements identified in the President's budget can begin to take effect sooner by building on existing programs.

We agree with you that the current administrative pricing system creates extremely complex provider payment systems that do not always function smoothly or equitably. In our view, these problems further underscore the need for the President's priority of fundamental modernization of the Medicare program. We believe the primary focus of the Congress should be on strengthening and modernizing Medicare, not on revamping outdated, overly complex payment systems.

While we appreciate the work the Medicare Payment Advisory Commission (MedPAC) has put into developing their proposals, we do not believe these ideas are the appropriate starting point for a discussion of Medicare provider payments.

We have no compelling evidence that there is a problem with the overall adequacy of provider payments, although we recognize that recent short-term adjustments have been substantial in the system Medicare uses to pay physicians. For example, while home health services are vitally important to the Medicare program, home health spending is expected to rise by over 42 percent this year and 12 percent next year, and this includes the adjustment to payments already scheduled in current law. And although certain provider payments may benefit from adjustment, we believe such adjustments can be accomplished without draining new funds that are even more urgently needed for improving Medicare benefits.

In the context of moving forward on our shared goal of modernizing and strengthening Medicare, the Administration is willing to work with Congress to consider limited modifications to provider payment systems in order to address payment issues. Most importantly, as we all consider changes to payment systems, we need to be cautious and recall that any increases in spending will be borne, in part, by beneficiaries in the form of higher premiums and coinsurance payments.

Therefore, while the President's Budget did not contemplate any particular provider payment changes, we are willing to consider limited adjustments to payment systems and to work with you to develop a comprehensive package that is budget neutral across providers. We will not support any package of provider payment changes unless it is budget neutral in the short- and long-term. To this end, we recognize that some provisions in law that, in the past, have restrained growth in payments are about to expire, and extension of these provisions is one potential way to ensure a budget-neutral package of reforms.

We believe it is possible to develop a fiscally responsible package of provider payment adjustments that remain budget neutral. We are happy to begin to work with you to provide technical support for such a package if you desire. Enclosed is some additional information on various provider issues that we hope will be useful in our continuing discussions of these issues.

We look forward to working with you to advance the priorities of a prescription drug benefit, a strengthened Medicare+Choice program, and a modernized Medicare Program, while also pursuing the issues surrounding modifications to provider payment systems.

Sincerely,

Tommy G. Thompson and Mitchell E. Daniels, Jr.

Administration's Views on Various Provider Payment Issues

Physician Payment Update

The current system for updating Medicare's payment for physician services was originally established in law in 1989, and has been adjusted a number of times since then, eventually resulting in the Sustainable Growth Rate (SGR) system that is used today. In general, Congress' goal for the payment system was to restrain unsustainable growth in physician payment under Medicare. The system has been working precisely as designed. Between 1997 and 2001, Medicare physician spending increased from 17.6 percent to 20.5 percent of total Medicare fee-for-service spending. Moreover, physician spending continued to increase, growing 5.3 percent in 1999, 10.7 percent in 2000, and 11.2 percent in 2001, far outpacing inflation in the broader economy.

Last year, a number of factors combined to cause the physician payment formula, as set in law, to produce a negative update. First, there has been a downturn in the economy, which affected the SGR because it is tied to estimates of the Nation's Gross Domestic Product growth per capita. Second, actual cumulative Medicare spending for physicians services in prior years was higher than expected. Third, information on services that were not previously included in the measurement of actual expenditures was now included. Had this information been captured in the measurements originally, spending increases would have been 5.9 percent in 2000, and 9.7 percent in 2001, rather than the respective 10.7 and 11.2 percent increases mentioned above. Counting these previously uncounted actual expenditures, as required by law, contributed to this year's negative update to physician payments. However, despite the negative update, overall Medicare physician spending is not projected to decrease this year. In fact, as the Congressional Budget Office (CBO) noted before Congress two weeks ago, program spending increases by 5.9 percent in 2002.

While a formula that produces these payment fluctuations year-to-year should be reviewed, the underlying system is sound and effective. As CBO Director Dan Crippen concluded in his testimony before Congress:

> "In considering whether to change the current system for setting Medicare physician payments, the Congress confronts the prospect of reductions in the fees paid per service for the next several years. MedPAC's recommendation would increase the Federal Government's spending for physicians' services under Medicare by $126 billion over the next 10 years. In contrast, other approaches might have the potential to lessen the volatility in the update without dismantling the mechanism for linking physician fees to total spending for physicians services or growth in the economy.

> Changes that increase Medicare payments to physicians will increase Federal spending. Incorporating higher fees for physicians' services into Medicare spending as currently projected would add to the already substantial long-range costs of the program and to the fiscal challenge to the Nation posed by the aging of the baby boomers. Raising fees would also increase the premium that beneficiaries must pay for part B of Medicare (the Supplementary Medical Insurance program). Inevitably, over the long run, higher spending by Medicare for physicians' services will require reduced spending elsewhere in the budget, higher taxes, or larger deficits."

We believe that considerations of sustainability and of our other urgent priorities in Medicare argue strongly that, if changes in the physician payment system are undertaken this year, they should be undertaken carefully and implemented in a way that does not significantly worsen Medicare's long-term budgetary outlook. The Administration supports reforms in physician payment that lessen volatility, and further believes that any short-term payment problems can be addressed at a much lower cost than the MedPAC recommendation implies.

Home Health

The President's budget also assumes no further delay in the implementation of the "15 percent reduction" in home health interim payment system (IPS) limits. As you may know, this reduction is somewhat of a misnomer. It does not translate into an across-the-board, direct cut in Medicare payment rates for home health services, as many have described it. Rather, the 15 percent reduction is a decrease in the payment caps under the old IPS. The actual percentage reduction in payments that will result from lowering the limits is much less. In fact, the CMS actuary estimates that the 15 percent reduction will only reduce payments to home health agencies by about 7 percent, not 15 percent. Further, after the PPS rates are reduced by 7 percent, we would apply the home health update (currently estimated to be 2.1 percent), leading to a net reduction of approximately 4.9 percent.

Home health spending is expected to rise by 42 percent for FY 2002. Even if the 15 percent adjustment occurs, we estimate that home health spending would increase 12 percent in FY 2003, 8.3 percent in FY 2004, and 7.8 percent in FY 2005. Therefore, we do not support a repeal of the 15 percent adjustment in the caps.

Skilled Nursing Facilities

Prior to the enactment of the Balanced Budget Act of 1997 (BBA), many nursing home companies were expanding rapidly, taking on significant debt, and leveraging themselves heavily for acquisitions of new homes and allowing their debt-to-equity ratios to escalate steeply. That strategy backfired on many of the industry's biggest companies when the nursing home industry came under financial pressure resulting from the implementation of the Prospective Payment System for skilled nursing facilities (SNFs) and other Balanced Budget Act of 1997 provisions. As a result, Congress passed two laws to provide some relief. The Balanced Budget Refinement Act of 1999 (BBRA) and the Medicare, Medicaid, and SCHIP Benefits Improvement and Protection Act of 2000 (BIPA) required three Medicare payment "add-ons": a 4 percent increase in per diem rates; a 16.66 percent increase in the nursing component of each Resource Utilization Group; and a 20 percent increase for certain categories of high-cost, medically complex patients. The first two add-ons expire on October 1, 2002. The third will expire when FIRS implements a case-mix refinement rule. The Administration is currently moving forward in its development of this refinement rule.

The President's budget proposal reiterates the Administration's commitment to paying SNFs fairly and appropriately for the delivery of services to Medicare beneficiaries. CMS recently explored the fairness and appropriateness of Medicare SNF payments in the February 6, 2002, *Health Care Industry Market Update—Nursing Facilities*. While we surely want to avoid overpaying any of our providers, we also must be sensitive to their funding needs in order to maintain high quality services. We are willing to continue to review the substantive justification for modifying SNF payments with the Committee.

Hospital Updates

Under the President's budget assumption, inpatient hospital payments for FY 2003 would follow current law and be updated by the market basket, which accounts for inflation in the factors that contribute to the costs to provide hospital services, minus 0.55 percentage points. Under current law, the update beyond FY 2003 would be equal to the full market basket. Since the inception of the inpatient prospective payment system (PPS), hospitals have received a full market basket update only once in FY 2001. Since FY 1984 hospitals have received on average approximately 60 percent of the market basket forecasted increase. Even so, since the early 1990's, the Medicare PPS inpatient margin has risen sharply from 1.3 percent in FY 1993 to a historical high of 16.0 percent in FY 1997. Although there was a decrease in FY 1999 to a 12.4 percent margin, the Medicare inpatient hospital margins have begun to increase again. In addition, since the early 1990's, there has been a significant drop in the number of hospitals with negative inpatient margins. In FY 1991, 61.2 percent of hospitals had negative inpatient margins compared to approximately 25 percent in FY 1999.

The stabilization of overall hospital margins in recent years suggests that, overall, the restrictions on market basket increases of recent years have not resulted in inadequate hospital payments. Reasonable and modest limits on hospital market basket updates would appear to provide adequate reimbursement for hospitals. Modest limits below full market basket updates could be linked to continued careful review of Medicare hospital margin data to ensure that margin problems do not worsen, and certain hospital types that show clear evidence of negative and declining Medicare margins could be monitored closely for special consideration. The Administration believes that the savings from such measured changes in hospital payment updates could be more than adequate to finance reasonable net increases in total payments to physicians.

There are market updates for other providers that were established in the Balanced Budget Act of 1997. To help restrain spending growth, you could also consider extending market basket update reductions to the calculations for other prospective payment systems.

We are prepared to provide further technical guidance to the Committee whenever it is requested.2

[Questions submitted from Mr. Shaw to Mr. Daniels, and his responses follow:]

Office of Management and Budget
Washington, DC 20503

1. Does the Administration's proposal to expand IRS' direct assistance to taxpayers filing online (EZ file) potentially create a conflict with private accountants and tax return preparers, running counter to OMB's Circular A–76?

Response: No, it does not. The primary objective of the EZ Filing Initiative is to make individual tax return preparation and filing easier and less burdensome by assuring access to a free, secure, online filing option for a significant portion of individual taxpayers. The IRS is moving toward providing additional access to tax services via the Internet. The Treasury Department and IRS are currently discussing a partnership with the tax preparation and software industry to make free online options available. If a partnership with the tax software industry is reached the initiative will reflect a unique partnership of the tax preparation industry and government.

2. What potential privacy issues has Treasury/OMB identified and how are you prepared to deal with them?

Response: Any online filing will have robust security to ensure the privacy of taxpayer information filed with the IRS. In addition, such filing will not compromise the existing regulations and standards that govern the use of taxpayer information. When partnering with the industry, certain privacy regulations and standards must continue to apply, all of which are currently adhered to by commercial preparers. Some examples include:

- IRC Section 7216 prohibits the use or disclosure of tax return data for purposes other than preparing the tax return.
- Companies who e-file returns today to the IRS must annually pass the Participants Acceptance Test to ensure the security of all transmitted data.

3. What internal agency conflicts potentially could arise by having IRS assuming roles as both tax return preparer and its existing role for developing regulations, collecting, and auditing tax returns?

Response: None. The IRS is committed to reducing taxpayer burden and the cost associated with preparing taxes. Just as IRS provides forms and instructions for paper filing of returns and provided Telefile via phones, this project moves tax filing to the next medium—the Internet.