S. HRG. 103-883

PRESIDENT'S BUDGET FOR FISCAL YEAR 1995

HEARING

BEFORE THE

COMMITTEE ON FINANCE
UNITED STATES SENATE

ONE HUNDRED THIRD CONGRESS

SECOND SESSION

FEBRUARY 23, 1994

Printed for the use of the Committee on Finance

U.S. GOVERNMENT PRINTING OFFICE

82-848—CC WASHINGTON : 1994

For sale by the U.S. Government Printing Office
Superintendent of Documents, Congressional Sales Office, Washington, DC 20402
ISBN 0-16-046510-9

COMMITTEE ON FINANCE

CONTENTS

OPENING STATEMENT

COMMITTEE PRESS RELEASE

ADMINISTRATION WITNESS

ALPHABETICAL LISTING AND APPENDIX MATERIAL SUBMITTED

COMMUNICATIONS

PRESIDENT'S BUDGET FOR FISCAL YEAR 1995

WEDNESDAY, FEBRUARY 23, 1994

U.S. SENATE,
COMMITTEE ON FINANCE,
Washington, DC.

The hearing was convened, pursuant to notice, at 10:15 a.m., in room SD-215, Dirksen Senate Office Building, Hon. Daniel Patrick Moynihan (chairman of the committee) presiding.

Also present: Senators Daschle, Conrad, Dole, Roth, Durenberger, and Grassley.

[The press release announcing the hearing follows:]

[Press Release No. H-8, February 16, 1994]

FINANCE COMMITTEE SETS HEARING ON PRESIDENT'S BUDGET, OMB DIRECTOR PANETTA TO TESTIFY

WASHINGTON, DC—Senator Daniel Patrick Moynihan (D-NY), Chairman of the Senate Committee on Finance, announced today that the Committee will hold a hearing regarding the President's Budget for fiscal year 1995. The Committee will hear testimony from Office of Management and Budget Director Leon E. Panetta.

The hearing will begin at *10:00 a.m. on Wednesday, February 23, 1994,* in room SD-215 of the Dirksen Senate Office Building.

"The Committee is interested to learn of the impact of the proposed budget on programs under our jurisdiction," Senator Moynihan said in announcing the hearing. "We also look forward to Director Panetta's observations on the program of last year's Budget Reconciliation Act and his views on the Balanced Budget Amendment which is scheduled for consideration on the Senate floor the week of the hearing."

OPENING STATEMENT OF HON. DANIEL PATRICK MOYNIHAN, A U.S. SENATOR FROM NEW YORK, CHAIRMAN, COMMITTEE ON FINANCE

The CHAIRMAN. A very good morning to our distinguished former colleague and very able and hugely respected Director of the Office of Management and Budget.

This is a regular annual hearing. It is the regular annual hearing at which the Director of the Office of Management and Budget is given the opportunity to come up and tell us what is in the President's budget as it concerns the Committee on Finance. This, by definition, is a very great deal because three-quarters of the budget of the United States comes through this committee. The more then we welcome this occasion to talk with our friend and former colleague and now very respected Director.

We were not going to have opening statements, but the distinguished Republican Leader is here and I wonder if he would not want to say something.

Senator DOLE. I would just welcome, Director Panetta.

The CHAIRMAN. There you are.

Senator DOLE. You are a friend of mine and we are happy to have you here. We know that you will give us nothing but accurate information.

The CHAIRMAN. Well, the record is open to be revised if at later periods it is necessary. Good morning, sir, and would you proceed. You have a written statement. We will place it in the record. Will you go forward just as you like?

STATEMENT OF HON. LEON E. PANETTA, DIRECTOR, OFFICE OF MANAGEMENT AND BUDGET, WASHINGTON, DC

Mr. PANETTA. Good morning, Mr. Chairman. I would ask that my statement be made part of the record. What I would like to do is walk through several charts that summarize the key points in the budget and then be open to questions from the panel.

Again, I thank you for your invitation. It is an honor to come before this committee. And, indeed, this committee does have jurisdiction over a good bulk of the Federal budget. This gives all of us an opportunity to look at those elements and determine what future course we need to take as part of our budget strategy.

The budget that we have presented, that the President presented, to the nation is a budget that tries to build on the foundation that was laid last year with the enactment of the economic plan. It is a tough budget. It tries to keep the economic recovery on track. It does it through very strong deficit reduction, continuing deficit reduction, almost $126 billion, a 40 percent cut in the deficit, plus key investments that must be made for our future.

I think that all of us recognize, whether we are Republicans or Democrats, that the 1992 election was a reflection of the frustration of the American people about the course of the country, with regards to the budget as well as the economy.

The American people were concerned about what was happening with the economy. They were concerned about the huge debt that was piling up to the tune of over $4 trillion. They were concerned about the ability of this country to provide jobs to people. They were concerned about whether or not their children would have a good future.

And for all of those reasons they wanted action here in Washington. They wanted both the President and the Congress no longer to just blame each other about the problems, no longer to just try to find ways around the problems, but to actually confront these problems. That essentially is the message that we tried to build into the economic plan last year, to take action and to try to reverse the path that we were on.

What we did last year, I think, essentially did reverse a lot of those practices. Instead of rising deficits that were going from $300 to $400 to $500 to $600 billion by the beginning of the next decade, we have reversed that path. We now have shrinking deficits.

Instead of a tax system in this country that was moving towards an unbalance, an unfairness, we have according to the Congressional Budget Office a tax system that is more progressive than at any time in the last 17 years. And instead of ignoring the future, we are investing, to try to improve economic growth and to make today's workers and our children more productive for the future.

And finally, the numbers that we present here are real numbers. We have not engaged in rosy scenarios about where the economy is going. The assumptions that are part of this budget are assumptions that are in the middle of the range in terms of both the blue chip as well as other economists. We have no gimmicks or smoke and mirrors similar to what was used in the past. What you see is what you get.

Let me just briefly describe, if I can, through the use of these charts the key points with regard to the budget. The first chart basically summarizes the key points in the budget itself as to what we were trying to emphasize.

First of all, we were trying to stick to the $500 billion in deficit reduction that both the Congress and the President enacted last year. There were some that wanted us to waiver on some of the provisions that were enacted, we refused to do that. We are sticking to the $500 billion, both with regard to revenue as well as the savings that were achieved in the entitlements.

In addition to that we are sticking to the spending caps. The spending caps are very tough. We are looking at a hard freeze in spending which means that what we spent in 1993 is what we are going to spend in 1994, 1995, 1996, 1997, and 1998. That is a very tough discipline that was enacted as part of the budget last year. We now have tough discretionary caps that are in place for 5 years.

In addition to that, as a consequence, we have the lowest deficit as a percent of GDP since 1979. We are looking at a falling deficit to GDP ratio. I will have some additional charts that will point out the significant change that we have. Instead of a GDP ratio that is going up, we are basically bringing that down and cutting it in half, as a matter of fact, by 1995.

In addition, we have a deficit that——

The CHAIRMAN. Mr. Director, this is too important to pass just without some metric. You say you are going to cut in half by 1995.

Mr. PANETTA. That is correct.

The CHAIRMAN. Do you want to say from what to what?

Mr. PANETTA. That is correct. We are approaching almost 5 percent of the deficit to GDP ratio in 1992. We are now looking at by 1995 cutting it to about 2.4 percent and hopefully 2.1 percent by the end of the decade. So instead of having a rising deficit to GDP ratio, we are now cutting that in half.

With or without health care reform, I should point out. I mean we are doing very well with regard to the deficit to GDP ratio.

In addition, we have three, if we reduce the deficit in 1994 and 1995, as we expect, it will mark three straight years of reducing the deficit. And as the President has pointed out, that is something that has not occurred in this country for over 40 years.

Lastly, CBO does essentially confirm the deficit targets that we have hit. As a matter of fact, CBO is baseline reflects lower deficits for the years 1994, 1995 and 1996.

The next chart reflects where the deficit was headed before the enactment of the President's plan and where we think we are headed now. The upper line basically reflects those annual deficits. As I said, what we were looking at were $300 billion annual deficits going up to $400 billion by the end of the decade. If you look at the early part of the century, they would increase again according to CBO's projections.

What we have done on the bottom is brought that down. The green line represents where we are with the 1995 budget, having brought the deficit down to approximately $176 billion. Then as we have pointed out, if we do not deal with health care costs in this country, then obviously the deficit starts to rise by the end of this decade and the beginning of the next century.

The red line indicates where we want to go with health care reform. Now that obviously involves some cost controls on health care. I hope whatever plan is adopted by the Congress you must absolutely focus on the essential cost controls that have to take place, otherwise we will have instead of declining deficits, having reversed that path, it will again begin to climb up.

I will have a point at the end of my comments here which I think will illustrate how important it is to deal with health care costs.

On the issue of deficits as a percent of GDP—this was the question that you asked, Mr. Chairman—this basically points out where we were going between 1989 and 1992. Deficits as a percent of GDP rose very close to 5 percent. By 1992 they were almost at 5 percent.

We have begun now to reverse those deficits as a percent of GDP. We are going down to a point that we think will be around 2.4 percent. As I said, we think we can bring that down to 2.3 percent and with health care reform down to 2.1 percent.

This is a very important chart in the sense that where we were headed and where we are now going represent two very different directions. I think it is extremely important, again whether we are Republicans or Democrats, that we keep the path of the deficit to GDP ratio pointed downward.

Obviously, to get there has not been easy because it involves some tough decisions, particularly with regard to spending cuts. What we have done in the budget is recommended the following kind of spending cuts.

Pete Domenici and I have done a lot of work on budgets. Pete used to always say the test of a good budget is whether or not you terminate anything and whether you get rid of anything. We have 115 terminations here that involve numerous programs, some consolidation of programs. There are about 30 programs at the Department of Education that we are essentially consolidating and asking that we do away with. So there are a number of program terminations that we have recommended here.

There are 300 cuts below the 1994 level. This is not below baseline by the way. In the old days we used to say baseline was considering inflation increases. This is 300 programs that are cut below what we spent in 1994. The 118,300 personnel reduction obviously reflects the decision to do a 252,000 reduction over 5 years. At the end of 1995 alone, we will have done 118,300 in the personnel reductions.

I would just mention the importance, therefore, of trying to get this buyout bill out of conference to try to assist us in being able to target the personnel that we want out. If we are forced to use RIF's, as you know, a senior person can basically bump somebody who bumps somebody else, who eventually bumped somebody down the line. And you eventually eliminate people who should not be eliminated.

Sometimes they should. Sometimes they should not. More often they should not. We are trying to streamline middle management. We have, frankly, an overload of middle managers and it is better if we can try to remove them.

We do about 16 billion cuts——

Senator DOLE. Can I ask you a question, please?

Mr. PANETTA. Sure.

Senator DOLE. You get a little help from the 1990 Budget Agreement, too, right? I mean, that was a bipartisan agreement.

Mr. PANETTA. There is no question that a lot of the things we built last year into the economic plan were elements, particularly the disciplines that were built in the 1990 agreements.

Senator DOLE. Including the total amount non-Defense discretionary spending. What is it, $540 billion or something in that area?

Mr. PANETTA. Well, there were caps that were established, as you recall, in the 1990 agreement. We did not have a hard freeze in place as we do now. But it obviously helped to create the discipline.

In addition to that we have the PAYGO requirement that was part of the 1990 agreement, which was also an important element.

Senator DOLE. That has been criticized by many in my party and I thought the first time we tried it was better than the second time. We could not pass the House Republicans the first time, so we had to go back and reduce some of the spending cuts which we did not think was a very good idea.

But I think it did help set the stage. I just wanted to reflect that.

Mr. PANETTA. I have always said that it was very important to put that agreement in place. Very frankly, I thought President Bush made a serious mistake by not wanting to claim responsibility for what we put into that agreement. I thought he made a serious mistake not taking credit for the steps that were part of that agreement. You have to make tough decisions. He made tough decisions and then he tried to back away from them. I think that was a mistake. There were some good things that were included in that agreement.

The CHAIRMAN. But what you have just reported to us, the crisis of public finance that was evident in 1990 and led to that summit, the Fort Andrews agreement, that leading up to the 1993 Reconciliation Act, seems to have broken the assent of deficit as a portion of GDP, which is a lot of shorthand. But what it means, if you kept going in that direction it was ruined. We seem to have reversed that direction.

Mr. PANETTA. Yes. I mean, we were clearly headed in a direction where I think ultimately this country really would have headed towards bankruptcy because we were headed towards $600 billion annual deficits. We were eating up private capital in this country. Just interest payments right now constitute, as you know, about $210 billion of our budget. A lot of that is just the interest payments that accumulated on that debt that was built up at that time. We just could not continue that path.

We have now successfully reversed that path. Whether we continue on that downward path is another challenge.

The CHAIRMAN. Right. But Senator Dole's point was a very apt one.

Mr. PANETTA. That is right.

The cuts themselves that—in the specific cuts, let me just mention the bottom point, which I think is important. It is a 5-year cut below baseline of $221 billion.

What do I mean by that? Let me have the next chart. Normally, as you know, in budgets we have usually increased spending, what we call a baseline budget that adds the inflation increases to the budget. And then in the past when we cut a budget, we normally have cut it from the increase in the baseline.

This budget, because it requires a hard freeze, will not permit any increase for inflation. Now we could debate whether that is a cut or not. I mean, I do believe, frankly, if we were cutting cost of living increases for retirees, most retirees would consider that a cut, even though it is a cut from an inflation increase.

There are obviously programs on the discretionary side where if inflation is increasing the costs of those programs and we are not maintaining inflation, people would consider that a cut—the student loan program, for example. If you have to pay more for college tuition and we are only providing a certain amount of student loan because that is what we are leveled at, that could represent a cut for that student.

But nevertheless, $221 billion is what we would have expected with the inflation projections that we are looking at over the next 5 years to be added to the discretionary budget. That is out. We are not going to be adding $221 billion. We are sticking to a hard freeze cap which means that we will not adjust any of the programs, except if we move money around under the cap, obviously.

If we decide to cut programs below the cap and increase certain programs, we have to do that below the hard freeze level that has been established in the budget. The cuts that we have looked at—we tried to establish some themes here to look at in terms of where we would seek the cuts in the budget.

Let me just mention this. As a percent of GDP which is also another measure, obviously, of where Federal spending is going, Federal spending as a percent of GDP—again between 1989 and 1992—was headed upwards. He was going to 23 percent Federal spending to GDP.

We are now looking at a course headed towards 1996 in which we are going to reduce overall Federal spending as a percent of GDP down to about 21 percent, near 20 percent. That again is an important chart in the sense that this was another path that we have reversed as far as this country is concerned.

But I think it is a measure of the trend that we have now established in terms of not only reducing the deficit but also trying to reduce the level or percentage of spending to GDP.

Let me go to the chart as to the themes for cuts, because there are obviously some sensitive cuts that are part of the proposal we have made. We tried to use several approaches as we tried to judge where the cuts should be made.

The first is managing government. This really flows from the Vice President's National Performance Review. The key cut that is represented here is the 118,300 on personnel reductions. We are going to be trying to implement procurement reforms. We are working with the committees to do that. That is another strong recommendation. We are trying to cut some of the bureaucracy associated with the whole procurement area and trying to improve that system. That will produce some savings.

We are also streamlining the Agriculture Department. We are looking at about 1,200 field offices that will be reduced in agriculture. That is a significant downsizing of the field office operation at Agriculture. But it is the kind of thing we have to do in order to manage government better and streamline our operations.

The end of the Cold War is continuing to produce savings with regard to where the Defense budget is headed. I would add that there are other areas where we are achieving savings as well. The Department of Energy has had, obviously, labs for the production of weapons. We are now able to reduce many of those labs and the production of those weapons. So that also is producing additional savings.

There are 7 of 14 departments that have less to spend in 1995 than they did in 1994—7 of 14 departments—and Energy and Agriculture are two of those.

We have better targeted government grants. I think we have to ask the question whether the programs that are in place in fact hit the targets that we establish.

There are some sensitive issues here. We have recommended, for example, that we tighten up on the low income energy assistance program and better target that program. It is not because we do not believe in assisting those who experience very cold weather.

When LIHEAP was developed as a program, and I believe most of the Senators here were around when that was developed, it came as a result of the embargo on Middle Eastern oil in the late 1970's. The argument at the time was because of the increased fuel costs, particularly in the Northeast, that we ought to try to target assistance to low income people that were impacted by those costs.

What has happened over a period of years is we have developed a formula that basically now distributes LIHEAP money almost like an entitlement, regardless of need. So that, for example, if I wanted to release $300 million to target it to the Midwest and Northeast as we had to do this last week, under the old formula I would be required to disburse some of that money to Hawaii, to California, to Arizona, to States that were not impacted by the cold weather.

So what I am asking for is the ability to try to develop a formula that is better targeted. The Congress gave us that authority as a matter of fact in the supplemental for the $300 million. As a consequence, we were able to target the States that really suffered temperatures below normal.

So by the ability to target the cold-weather States, plus counting the number of low income households, we have been able to take that program and make better sense of it and target the people who are really in need. So I would ask for that kind of cooperation in terms of that program.

Operating costs on transit subsidies. This is also a sensitive issue. The approach by the Secretary of Transportation is that when it comes to the area of mass transit the Federal Government has a more important role to play with regard to capital expenditures—helping to buy the buses, buy the cars, build the rail systems.

So what we recommended was almost a 40 percent increase with regard to the capital subsidies that are provided in mass transit, almost about a $650 million increase on capital subsidies.

But in exchange for that we wanted to reduce the level of operating subsidies and allow the communities hopefully to pick up a little more responsibility on that front. I know that is controversial. I represented an area where we depended on operating subsidies. So I know the sensitivity of that issue.

But on the other hand, if we are going to target money where we really need to, it seems to me the capital side of the budget is where the Federal Government ought to devote more of its resources. But that is an issue we need to debate and obviously we present that as an issue to be debated here.

On public housing, this is another issue where we were concerned about targeting. Let me tell you the problem with public housing. Again, it is not that we are against public housing. It is that we have a pipeline in public housing of almost $8 billion. It basically is a program in which we keep putting money into budget authority, but the public housing is not being built at the other end for whatever reason.

In part it is complications at HUD, in providing approvals; it is complications at the community level, getting approvals for the construction of public housing. But what is happening is, it is not coming out. And what we need to do is provide incentives to those communities that are building the public housing and reward those building the public housing instead of just creating this fiction where we are putting more money into budget authority and not producing the public housing on the other end. Those are the kinds of questions that need to be asked and that we need to work on together.

Nonpriority programs, obviously there are—I have often said, I guess there is no real nonpriority program. It depends on who you talk to. Everybody has a priority with regard to a particular program or it would not exist. But clearly we have to make decisions about areas where we do not need to pump additional funds, programs that can be eliminated and the programs that really do not count for the future.

The whole thrust of this budget is that when you set a hard freeze, Congress has to make judgments, the President has to make judgments, about priorities. What programs should the government not be in? What programs should we cut back on? Which programs do not work and which programs should we funnel money into? That is the fundamental kind of challenge that faces all of us now, particularly with this kind of budget.

And finally, paying for government services. Obviously, we have provided some fees. The fee with regard to gun dealers is an example of that that the Treasury has recommended. I would point out that generally we are not proposing a huge amount of fees here.

Compared to the Bush budgets, we are about one-half of what was proposed in fees.

But again, we do feel that there are areas where the Federal Government ought to be compensated for the services that are provided. So there are some fees that are included.

With regard to the investment areas, and this again is the thrust, if you want to put money into investments you have to find the cuts. You have to be able not only to stay within the cap but to determine in what programs you are going to find savings and what programs are important to emphasize.

Obviously, these are the areas that the President, and I think frankly many in the Congress, would support. We are looking at education and training programs. We are looking generally in this area at about a 24 percent increase over 1994 for education and training.

What I mean by that is essentially on education, for example, we are including additional funds for Title I, for disadvantaged elementary students, the Title I program that is currently going through the Congress, Goals 2000, education reforms, which is currently working its way through the Congress. We have the School-to-Work apprenticeship program that we are funding, plus the national service program which is being funded.

The WIC nutrition program I would also point out for pregnant women and children is being fully funded here as well. On the training programs, the President will introduce a proposal for workforce security to try to combine some of the training programs that we currently have, so that we are not only training but also placing people.

I think very frankly this is an area that all of us need to ask questions about, whether or not current programs in this area are working. There are some we have identified that are not working very well. We need to consolidate those, develop a workforce security program that can be used not only for dislocated workers, but can be used as part of a welfare reform effort as well.

In addition, we are looking at infrastructure. The whole technology and infrastructure area is increased by almost 22 percent. In technology we increased investments for the NIST program. We increased investments for defense conversion. We increased investments for infrastructure for full funding of ISTEA.

Congress passed the ISTEA bill. It is important. We want to provide full funding for the highway program under that proposal. It is not easy to do because you obviously then have to find some savings elsewhere, but that is a priority. We think it should be done.

The CHAIRMAN. That, sir, is not just a priority, it is the Lord's work.

Mr. PANETTA. And the Lord sits in front of me. [Laughter.]

I think the point is, I mean the Chairman and others did put a lot of work into that proposal and we think we need to stick by that formula.

Rural development initiatives are also targeted for some help because we think again, particularly with regard to clean water, sewage, rural initiatives have to be funded as well.

On the environment we have an increase that we are recommending of about 24 percent. Largely, that is in clean water initiatives and safe drinking water. We try to meet the challenge of unfunded mandates. We have a tremendous requirement that is out there on clean water, safe drinking water and we are trying to provide the additional funding to the States and communities to be able to meet those requirements.

On health care, aside from the health reform bill, we do provide additional funding for the NIH, about a 5 percent increase for the NIH and research efforts. It is the largest increase recommended by a President in recent budgets. We have also provided additions for the Ryan White Act to try to deal with those communities that are impacted by the AIDS epidemic. We also provide additional funding for drug treatment, particularly for hard core drug users.

Fighting crime. Because of what the Senate did on crime in enacting the $22 billion that would be devoted towards law enforcement efforts, we have taken $2.7 billion of that for 1995 and basically implemented it in the budget for providing 100,000 police on the streets, implementation of the Brady bill, some of the community partnerships against crime, particularly in the Department of HUD, as well as a major initiative to try to tighten border security and to try to slow down illegal immigration into this country.

And lastly, on national security, as the President has made very clear, we have set a path for defense savings. We want to maintain that path and not wavier from it, because we think as a result of the bottom-up review that the path we are on does, in fact, provide a good force structure for this country, good security for this country, and at the same time achieves the savings that we think can be achieved as a result of the end of the Cold War.

In the end, Mr. Chairman, and members, the test of any economic plan or budget for that matter is whether it is working or not. We think that the effort to reduce deficits, to discipline spending at the Federal level is having a very positive effect and is contributing to the economic recovery.

I think the indications of what is happening in the economy in fact confirm that. We are seeing greater private sector job creation as a consequence. I mean, obviously, a part of this is the recovery itself, moving forward, but a lot of this is investment that has been freed up because of deficit reduction. Instead of having the Federal Government basically absorb that investment capital, this is investment that is going to businesses. And as a consequence, we are seeing job production almost double what we saw between 1988 and 1992.

This next chart, I think, indicates where real economic growth is headed. We are now seeing economic growth at again almost twice the level that we saw over the last 4 years. It is on the right path. We are seeing economic growth headed in the right direction right now.

The last point I want to make is on investment. This is on investment and equipment. It is eight times—and this chart probably tells it all. You now have eight times the level of investment in terms of fixed equipment that we have had over the previous 4 years. It is obviously a result of lower interest rates. It is obviously a result of greater capital availability, and it is a result of greater confidence in the direction of the economy.

Now let me tell you what the concerns I have are. I have expressed the positive side of this picture. Let me share with you what I think some of the concerns are.

We are looking right now at the next 5 years. You have to ask the question: Where is the major increase in spending going to take place over the next 5 years? Ninety percent of the increase in spending over the next 5 years—90 percent of the increase in spending—is in these following areas: Health care, which is almost going to add about 50 percent to the deficit; interest payments on the debt, obviously, which is a problem that has developed as a consequence of that $4 trillion national debt, which is not something we can do anything about directly. I mean you cannot just stop interest payments on the debt, obviously. So that is an area where we have very little to deal with other than to ultimately try to reduce deficits.

Social Security is another area that is expanding because of the people who are living longer and, therefore, draw their benefits. On the other hand, Social Security also happens to be a system that pays for itself and that is in surplus. So that it is a system that basically is handling the increase that we are seeing here with regard to Social Security.

The yellow portion there represents other entitlements, basically agriculture, AFDC, some of the programs that serve the poor. There is very little increase. There is probably an increase there that reflects inflation more than anything else.

Senator CONRAD. There is no increase in agriculture; is there?

Mr. PANETTA. Not at this point.

Senator DASCHLE. Mr. Chairman, could I ask, Leon, does that include the cuts that are already in the present budget for Medicare and Medicaid?

Mr. PANETTA. That is correct.

Senator DASCHLE. So all the red is after the cuts?

Mr. PANETTA. That is correct.

And the small—you cannot even see it, but the small red line at the bottom represents discretionary spending. So the main point here is that we have done a very good job on discretionary spending. When you develop a hard freeze on discretionary spending and you basically have laid out a flat cap, you have a very tough budget on discretionary spending.

On the entitlements, the chief culprit here is the health care side of the entitlements. We have to do something to control those costs in the out years. That is why, obviously, doing something on health care reform is so important in this Congress to maintain that path we are on towards reducing the deficit and keeping us on a downward path.

These efforts complement each other. The first obviously was to put the economic plan in place. The second is to stay on track with discretionary spending. The third is to do health care reform. The fourth is to do welfare reform as well, because that, too, will provide some additional disciplines in that area.

The fifth is, we have asked the Kerrey Commission, represented by members here, to look at additional savings that we can achieve in the entitlement area to try to implement additional disciplines, to try to maintain that path that we are on. This is the future. This is the next challenge that we absolutely must address if we are going to be able to keep those deficits on a downward path.

Let me, if I can, in summary mention some of the mandatories here that we ultimately are going to have to deal with. One is obviously health care reform, and I have mentioned that. The second is welfare reform. We think it is very important. The President will introduce a welfare reform proposal. It is aimed at trying to promote parental responsibility, at trying to take people off of welfare and put them to work, trying to substitute work for welfare by providing education and training, but expecting work at the end of 2 years by people on welfare, and trying to improve the systems that we do have to try to provide the support system that is necessary in order to get welfare reform done.

Mr. Chairman, you provided great leadership on this issue with the Family Support Act of 1988. There was a great deal of support for that in the Congress.

The CHAIRMAN. This committee did.

Mr. PANETTA. That is correct.

And I think if we can build on those efforts with the welfare reform proposal, I think we can, in fact, implement something that will truly be beneficial for the nation and particularly for the people involved in the system.

On GATT, let me mention, this is an issue that is mentioned. Under the PAYGO rule we are required to pay for that treaty as we did with NAFTA. The reason we have not included specific proposals in the budget is because this is an area, frankly, that has to be negotiated between Democrats and Republicans alike in terms of paying for this proposal. If we can develop a way to pay for it together, then that is the way we ought to do it. That is essentially what happened on NAFTA, is we worked together to develop the PAYGO initiatives.

It is not going to be easy. We are looking at a cost right now on GATT of anywhere from $12 to $13 billion.

The CHAIRMAN. $12 to $13 billion?

Mr. PANETTA. That is correct, over 5 years.

The CHAIRMAN. We have been thinking $11 billion and thinking that was a lot.

Mr. PANETTA. Well, it could range as low as $11 billion; it could range as high as $13 billion. For that reason, this is an area for those that support the passage of that treaty, we have to negotiate the PAYGO part of that out together.

The CHAIRMAN. Senators, could I call that to our attention. The budget does not provide the $12 to $13 billion we will need for the GATT. So we will have to find it ourselves, but in cooperation on this.

Mr. PANETTA. That is correct. We are currently in the process of developing proposals. What I would like to do is to sit down with both the minority and the majority here.

The CHAIRMAN. We do not have minorities and majorities on this matter. You sit down with us and you are welcome any time.

Mr. PANETTA. Good. Then we will do that, because we do need to sit down and work through the proposals here because this is going to be a difficult challenge as well.

To sum up, I think as the President has said, this is a tough budget, but it is also, I think, a very important time for us to reset the destiny of this country, particularly with regard to our economy as well as our budgets. We look forward to working with you. We present budgets, as always, on the basis that we have to work together to try to ultimately implement their provisions.

As a member for 16 years up here, I am a believer in the legislative process and the Congressional process and the fact that we do have to work together to achieve these goals. But we are working within some very tight time lines here. We are also working within some very tight constraints. It is going to require some tough choices. But this is the way we need to do business for now and for the future.

[The prepared statement of Mr. Panetta appears in the appendix.]

The CHAIRMAN. Well, sir, thank you very much indeed. It was a very clear presentation. And for the first time in a long while generally good news. I think Senator Dole made the point that between the 1990 agreement on the deficit and the 1993 budget reconciliation legislation which we finished in August, we broke that steady ascending deficit as a proportion of our total national product.

It was going up. It has clearly stopped a year after the 1990. It went up the next year, but then it leveled off and it is now coming down. If we can keep that, we shall have done more for our economy than any other thing within the capacity of the Congress to do or so I would think.

But now to questions. I am sure there will be many. Senator Dole?

Senator DOLE. I wonder if I could have that chart that has 1988 and 1992, then 1993.

Mr. PANETTA. On the GDP, the deficit?

Senator DOLE. No. The one that showed—the next to the last chart you had there. That is it, yes, investment has grown. Again, I know the Budget Director wants to put the best face on, but if you just had the year 1992 there and 1993, I think it would be a much different chart, because we did take action in 1990. And normally it takes 12 months or 18 months to have any impact.

We did not really pass the Clinton budget, it was not signed last year until August 12, almost in the fourth quarter of 1993. So you could not have had all these great things happen in the last 3 months of last year.

Again, I want to underscore the point that some of us voted for that 1990 agreement and we were later criticized for it. But I think the record—I understand the reason the administration would show 1988 to 1992. But I think the record would show we did have an impact and it did start to show up in 1992, particularly in the last quarter. And it carried over into 1993 and then had a very strong fourth quarter in 1993. Three weeks after we passed the Budget Act the fourth quarter started or 2 to 2½ weeks.

The CHAIRMAN. Perhaps we could ask the Director to give us the numbers as you have described them, because clearly the last quarter of 1993 was not the affect of the budget signed.

Senator DOLE. No, it had not taken affect yet.

Mr. PANETTA. Senator, let me say, first of all I think that as I have indicated there were important disciplines that were put in place as a result of the 1990 agreement.

But had we not enacted additional deficit reduction, the additional $500 billion in deficit reduction, I think you would have seen a very different chart here, because the reality is that what happened was that when we in fact offered the economic plan, I think everyone recognized we were serious, and we began to see the impact on interest rates actually early last year, even before we passed the economic plan.

But the fact that we complemented what happened in 1990 with the additional $500 billion in deficit reduction sent a very clear signal to the country and to the money markets that, in fact, we were serious about reversing that trend in terms of the deficit.

So I think both had to work together. It took both actions to drive us in the direction we are headed in and you could not have done one without the other. If we had failed last year, if we had failed to put deficit reduction into place, you would have seen a very different picture because most people would have said we really are in bad shape. Interest rates would have continued to go up.

But because we were able to complement what happened in 1990 with the additional deficit reduction, I think you saw a much more positive result. So some of the—I think there is enough credit to go around for everybody. But I think that really is the clear picture, Senator.

Senator DOLE. I am not trying to establish credit. But I think there is a reason for it. I do not think we know what impact the $255 billion in new tax is going to have yet. I think it is going to take—and it may not be $500 billion. I think the CBO has reduced it to about $430 billion in deficit reduction. So I think it is going to take, what, another 12 months before we really see the impact of the first Clinton proposal.

I do not suggest there was not a good effort on the part of the President. I mean it is the effort he wanted to make.

I wanted to just mention one other area because there are a lot of things where "past budgets were declared dead on arrival." This one was sort of "missing in action." Health care reform is not in there. Welfare reform is not in there. GATT is not in there. The National Work Force Security Act is not in there. There are a number of the extenders, like targeted jobs tax credit and others that are not presented in the budget.

So we have to find all that money. This committee really has a burden when it comes to trying to find all the offsets. I do not know what your charts would look like if you put all these things in here that are probably going to happen. Targeted jobs tax credit I assume will be extended and there are others. Low income housing now is a permanent program, so that is in here.

The CHAIRMAN. We did that one.

Senator DOLE. We did that. That is an affirmative base. That is in the budget. So I guess the point I would make is that certainly I think you are going to have a lot of support, bipartisan support, on some of the cuts. But many of those 115 terminations have been coming up here every year. They could find their own way up here. You know, they came up for 8 years of Reagan and 4 years of Bush.

They do not need anybody to bring them up here. They know how to get here. But they always survive.

What is the total savings of 115 terminations if you added them all up?

Mr. PANETTA. It is somewhere around $2.5 to $3 billion.

Senator DOLE. You do not expect you will get them all, right?

Mr. PANETTA. Well, you know, everybody has to find some place to find the money. There are two places to go. One is that you reduce the level of investment in education or technology, for example, and the other is that you find other places to cut.

Senator DOLE. I just attended a press conference with Senator Cohen from Maine who introduced a bill today, along with Senator Kohl of Wisconsin, about another little program, SSI program, where they determine in the Committee on Aging, and we have jurisdiction of the SSI program. There is $1.1 billion a year being spent for alcohol and drug addicts.

You know, you talk about a small program. That is one I think we will look at on a bipartisan basis, not that we do not want them to get treatment. They do not get treatment. They take the money. In fact, there are even cases where the payee is the local bartender. He gets the check. He does not have to worry about going to the bank; you just go there to get your liquor and the government takes care of all that for you.

The point I would make is there are errors. It would certainly be helpful to the administration. I know your good work in the House as Chairman of the Budget Committee, and I have a lot of confidence in you and Senator Domenici together. We will try to do the best we can to support you in some of these very tough cuts.

If you added up all the things that would be left out, what would be the picture?

Mr. PANETTA. Well, I mean a lot depends, obviously. On health reform we did include in the budget those elements of Federal spending that were part of the health reform proposal. What is not in the budget numbers is obviously the premiums. We have, obviously, a dispute with CBO as to whether or not premiums ought to be counted as Federal receipts.

But, obviously, if we are to view premiums as a Federal receipt—and we would think that would be a bad precedent—but nevertheless, if that were to be the case, then we would reflect that in the budget as well. So we took the position we are going to put everything that we think goes into and comes out of the Federal Treasury in the budget and you will find it there.

On welfare reform, to be frank, Senator, we have not decided the elements of welfare reform. We are in the process of doing that. We will introduce a bill the 1st part of April.

The CHAIRMAN. The 1st of April?

Mr. PANETTA. In that area, the first part of that month.

The CHAIRMAN. The 2nd of April.

Senator DOLE. The 2nd would be better, yes.

Mr. PANETTA. Maybe the 2nd would be better.

Senator DOLE. Let us go for the 2nd.

Mr. PANETTA. under the PAYGO requirements we are required to pay for it and we will do that. Whatever we submit is going to have to be fully paid for and CBO is going to have to score it as being paid for.

On the extenders, frankly, on the extenders we felt if we do the extensions on the extenders for early next year that we have more than sufficient time to do the extenders in the next session.

The CHAIRMAN. Could I just interject here? Senator Dole mentioned the targeted jobs tax credit. It also includes employer educational assistance, about which this committee feels strongly and correctly I believe.

Mr. PANETTA. I think the administration shares that concern.

Senator DOLE. Did you want to put in a good word for the balanced budget amendment while we are here?

Mr. PANETTA. Senator Dole, I have expressed myself on that a number of times. I respect the people who believe that somehow we have to change the Constitution to balance the budget. I respect those viewpoints. But I am a believer that you do not have to change the Constitution to do what is right.

The best evidence of that is the last 2 years. The President was willing to exercise leadership; the Congress is willing to make tough votes. That is the way our forefathers intended this process to operate. They did not require a balanced budget amendment. Twenty-eight Presidents have reduced deficits in the history of our country without having to rely on an amendment to the Constitution.

I just think we begin to trivialize the Constitution if every time there is a policy failure of some kind we have to change the Constitution. We do not do it for crime. I mean, people could say we are not controlling crime, so let us change the Constitution to say that we are opposed to crime. We are not controlling drugs, let us change the Constitution to require that we are opposed to drugs.

The CHAIRMAN. Sir, I do not think you are changing his mind.

Senator DOLE. No, I think——

Mr. PANETTA. No, but I am feeling good about it. [Laughter.]

Senator DOLE. I think I will just put you down as undecided.

The CHAIRMAN. Put you down as undecided. [Laughter.]

Thank you, Senator Dole.

Senator Grassley?

Senator GRASSLEY. On Defense, you're over programed by $20 billion for the next 4 years. I do not expect you to answer that now, except it is just a fact—we are over programed by $20 billion. Somebody has to come up with $20 billion to spend more there or $20 billion to take out of the programs.

But what I am interested in right now is the fact that we have not filled in some of the blanks for the out years. I have asked you for that information and there has not been a deadline come up yet. But I would like to have it, if I could, by February 28 so we would have time to factor it in and consider the impact in the out years before we adopt your budget resolution.

I submitted that in writing to you as a result of your appearance before the Budget Committee and I just wanted to kind of emphasize that at this point. You do not have any disagreement that we are over programed by $20 billion?

Mr. PANETTA. Senator Grassley, I——

The CHAIRMAN. Could I just interject so that our listeners will understand? By over program, would you just want to define that, Senator Grassley?

Senator GRASSLEY. Yes. We have appropriated X number of dollars for Defense and the Defense Department has programs underway that will actually spend $20 billion more than what we have in there. So we either have to appropriate $20 billion more or they have to bring their programs down.

Mr. PANETTA. It is not quite that simple, Senator. What we have said is the reduction in the Defense area over the next 5 years is based on a bottom-up review. There are two complications that involve consideration. I think this is what you are pointing to.

The first is the pay increase. We had recommended last year a pay freeze for both military and civilian employees. The Congress did not go along with the pay freeze, provided an increase on the military side, and provided a locality pay increase on the civilian side.

That became then a cost that had to be absorbed by all Departments. It is a significant cost at the Defense Department in excess of $10 billion over the next 5 years. Pursuant to an agreement that was discussed and worked out between the Chairman of the Senate Armed Services Committee and the Vice President, we provided additional funding in budget authority to the Defense Department to cover the pay issue. They have indicated that they are able to do that over these next 5 years.

The inflation issue is the second area. The Defense Department, as with other departments that have to base their contracts over a period of time, have to basically gauge a certain inflation number for the future. Because of adjustments in that inflation number and the projections in that inflation number, we had initially thought that the costs would be somewhere around $30 billion that might be added in terms of additional costs, but now that number is somewhere around $20 billion.

Again, other departments are required to eat that inflation adjustment in their projections. With the Defense Department, what we have agreed to do is to continue to review each year's budget because there are continuing changes in the inflation projections.

So it may very well be that instead of a $20 billion problem, it could a $10 billion problem, it could be a $5 billion problem, depending on where the projections on inflation are going. So I would not jump to the conclusion that we automatically are in excess of $20 billion. That is a year to year judgment we ought to make based on where inflation is going.

Senator GRASSLEY. I think he accurately describes the situation. The only thing I would say that you ought to be able to do in your position is that you have to know when you put your budget together what the inflation factor is for every other program in government. We have that factor for every other program in government. We need it for Defense before we can go ahead and make our decision. It seems to me that it is legitimate that we have that.

Could I follow up on another question? The Chairman has already started or brought this discussion up about welfare reform. I do not have any problem with the answer that you gave him about what was in the New York Times and financing and everything. But is there any, as you are involved with the Vice President on reinventing government, can we not presume that the same principles that apply across the board to reinventing government, doing things more efficiently and effectively, and having costs within government from reinventing apply to welfare reform as well as just a matter of a starting point?

I do not think that has been the discussion yet. The discussion has been, well, if we are going to have welfare reform it is just going to cost X number of dollars more.

Mr. PANETTA. To the contrary, the debate that is going on within the administration has been looking at all aspects. As a matter of fact, we are looking at about 30 to 40 options for possible funding of any kind of welfare reform proposal. And savings within the programs are among the areas that we are looking at in line with the national performance review.

I think we are right, Senator. We ought not to just assume that the programs are all operating properly. The SSI program, what came out today, is the best example of the kind of thing that has concerned us. It is true for SSI. It is true for other disability programs. We now have a task force that is reviewing those programs because of the concerns that were raised by Senator Cohen and others.

Senator GRASSLEY. Well, then within the principles of reinventing government, can we not assume that a more efficient and a downsized welfare program would not necessarily cost $7 billion more? That was the point that I was trying to make.

Mr. PANETTA. Well, I think depending on how you design welfare reform you have to ask, the first question is, obviously, what are the basic elements involved in welfare reform and what are the costs of implementing those elements.

Secondly, how do you transition the program in because you cannot just immediately put the entire reform in place. You have to transition any program into place.

And then ultimately once you have put that full program into place, what are the savings that can result. It is all of those elements that have to be considered.

So I do not dispute what you are saying, which is that we ought to look ultimately to some savings here. But I think the question of whether or not those savings can fully fund welfare reform depends an awful lot on what are the elements you are trying to put in place with welfare reform itself.

Senator GRASSLEY. Thank you, Mr. Chairman.

The CHAIRMAN. Thank you, Senator Grassley.

Senator Durenberger?

Senator DURENBERGER. Mr. Chairman, thank you.

Leon, thank you for being here. If I may, I would just like to use the occasion to explore a little bit of the big red line called health in the future, if you do not mind.

The CHAIRMAN. A real red line.

Senator DURENBERGER. And just sort of get a sense of how much we really all have in common because there is so much of an emphasis on how different we are, from where the President is and so forth in reform. But it will help me to understand how you are accounting for this if you can help me understand both your satisfaction level with this and your frustration level.

When Bob Reischauer was here, the figures that he gave us for 10 years from now were that health care expenditures would rise to approximately $2.220 billion in the year 2004. That is all public and private expenditures combined. That is if nobody does anything, the combination of the red line, which I assume is a Federal subsidy and all other costs, would rise to $2.220 billion.

Then he indicated that if we adopted the President's program, the costs in 2024 would rise to $2.070 billion and rounding it off I guess we talk in terms of percentages of GDP at 20 percent if we do nothing, 19 percent if we do all of these alliances and all the rest of this stuff.

My question of him was, and I ask it of you, number one, are those figures accurate. Then secondly, from your experience in this body and your vision of the future, and your concern for this red line, why would we go through all of the struggle over reform and satisfy ourselves with $2.070 billion in expenditures 10 years from now, if, in fact, we knew we could do better than that. And maybe therein is the problem.

But I know we can do better. I come from a State that is doing better. I can look at national statistics. I can spend the rest of the day here with you on geographic—I can go to the place where you come from in California and I can describe efforts at restraining costs and improving quality and improving services.

I know that if we did what you do in your area and what we do in my area we would be a lot less than 19 percent of GDP. So my first question relates to your own personal comfort level, that $2.070 billion is our settled goal for health care reform 10 years from now.

The CHAIRMAN. Sir, did you say $2 billion?

Senator DURENBERGER. Yes. Today it is like 9 hundred and some billion. I do not know what the figure is.

The CHAIRMAN. Do you not mean trillion?

Senator DURENBERGER. Yes. Sixteen years and I cannot think in those terms.

Mr. PANETTA. I forget some zeros in there also.

Senator DURENBERGER. $2.070 trillion in 1 year and we are going to go through all this agony, all this effort, to settle for that.

Mr. PANETTA. Senator, I have some of the same discomforts that Bob Reischauer has as we look at the numbers here, because in large measure we are dealing with cost estimates that we really have never projected before.

As I have indicated I think to this committee and others, it took us almost 6 months to develop some of the models for basically trying to score the costs on the proposal that the President put together because for the first time you are asking the question, what happens when you bring 30 or 40 million Americans onto the health care system; what is their utilization; what is the impact on businesses; what is the impact on employees?

Those are questions that we frankly did not have very good models for and we developed the best we can. I think they are as accurate as have ever been developed in that area. Obviously, we are working to try to tighten up on these cost projections as much as possible.

But we are dealing with an area, as I said, an area where we do not have the kind of accurate cost estimates that we have had in other areas and we are trying to develop those. We are going to have to work with the Congress. We are going to have to work with the members of this committee. And we are going to have to continue to work with CBO to try to develop the best estimates possible.

Let me just say in response to your question, I think you know what the problem is. You know what that red is. The problem is it has to be confronted. I believe the administration is open to proposals to try to deal with that cost escalation out there. We have to do that.

Senator DURENBERGER. Well, let me make two suggestions.

The CHAIRMAN. I know what you are talking about. You are talking from page 26 of the CBO study.

Senator DURENBERGER. I am talking from memory.

The CHAIRMAN. But you are absolutely right though.

Senator DURENBERGER. Thank you.

The second thing that we talked about and this was the Chairman's motion, I believe, at that meeting is that we ought to have some kind of a little gathering of some of these experienced estimators at some point in time and try to find out if we are all estimating the same sort of thing.

Because the argument that the President will make on the managed competition part of his bill—the alliances and so forth—is the same argument the rest of us will make on behalf of alternative approaches to managed competition. That is, you cannot bring either the red line or any other of these costs down unless you change behavior.

We do not have—we did not get from Bob Reischauer an estimate of behavior changes. We got the usual static estimate based on whole figures and things like that. We desperately need—we who are in this health reform thing together—we need to put our heads together and find out if we can come up with a more reliable estimating process, which may in part be retroactive after we see things happen that we can convince and use to convince the American people, that in fact reform is worth it, reform is going to save money as it extends coverage.

And the Chairman said at the conclusion of this discussion weeks ago that he thought it would be a good idea that we get some people together to discuss this issue. I hope CBO is part of that.

The CHAIRMAN. And we will ask them to be and ask OMB. Can I just make the point since I have the advantage of—Dr. Podoff handed me the relevant chart. You are aptly right that the administration projects that by the year 2004 with health care reform the total national health expenditures will be $2.070 trillion. Without there would be $2.220 trillion. The savings is $150 billion, which is not a small sum, but even so it is 7 percent. It is not something radical.

Senator DURENBERGER. Mr. Chairman, can you imagine how enthused we could be about this process if the goal were that 10 years from now health expenditures, rather than being 19 percent of GDP or 6 percent more than they are now would be less than they are today as a percent of GDP?

I think the American people would get more interested in what we are doing. They do not understand managed competition. They do not understand alliances. They do not understand any of this sort of stuff. But if, in fact, the people that say they understand this are convinced that a national goal of health expenditure that is something other than a 6 percent of GDP growth is possible, then they may say, well, those guys sound like they know what they are doing.

The second point I would like to make, if I may, Mr. Chairman, with due respect to my colleague from North Dakota, in the red, the red I take it is the Federal subsidy expenditure.

Mr. PANETTA. Federal cost. That is correct. Incidentally, that is not based on health care reform. That is based on where we are headed right now.

Senator DURENBERGER. Exactly. Exactly. But in it the component parts of Medicare, Medicaid, the tax subsidies and those sort of issues.

Mr. PANETTA. That is correct. The subsidies are not in there.

Senator DURENBERGER. The tax subsidies are not in there?

Mr. PANETTA. No, that is basically Medicare and Medicaid costs right now.

Senator DURENBERGER. Wow. And again, just by way of a suggestion, my view of the politics of all of this is that we are spending too much time debating alliances and a bunch of things like that and we are not spending enough time discussing what this committee is going to have to discuss, that is what are the component driving policy forces behind these red lines.

Mr. PANETTA. You are absolutely right. I think unfortunately caught up in this kind of criss-cross debate that is taking place, we continue to lose sight of one of the major questions. I mean, obviously, one of the questions is universal coverage and that is one of the principles.

But we also have to look at, what is the most effective way to control these costs. That is a fundamental issue here. Because if we provide universal coverage but have these costs escalating out of control, we will not serve this Nation very well. So you have to ask that other question.

I guess the answer to your question, Senator, is that we really do need to—I mean, obviously, CBO has focused on the President's program, at least to the extent that in 10 years it does show that we are moving in the right direction. There is some hope here.

I hope that they look at other proposals that are before the Congress and give us their evaluation of the savings in these other proposals, because I would wager to say that when you look at the other proposals, we are probably going to get a worse picture.

Senator DURENBERGER. Sure, because every one of the other proposals on the coverage side does the political thing and gets out. At least the President has not done that. He has made political compromises but he has said this one is paid for, we pay for it with an 80 percent employer mandate.

The rest of us have said, you know, we ought to do Medicare restructuring but we do not tell you how to do it. We ought to do low-income vouchers. But I think we are a little bit more precise on how to do that than other people. But the reality is, Medicaid policy drives costs up. Medicare policy drives costs up. The tax policy drives costs up.

Those are the three driving forces behind this. And no matter how hard the market may work out there to try to take charge of this, the basic policy is what is driving these costs up.

I am going to put in the record something I just learned about risk contracts because I hope you have some wonderful people who work for you that know about Medicare risk contracts and what they are doing in your old District and what they are doing in Minnesota and so forth. But I think the Chairman would be very interested in seeing how people who are trying to contain costs by buying through risk contracts are actually, you know, demonstrating how you can bring these costs down, but they are being penalized by the way the current system works.

I will put those in the record. I wish I had a little chart just to show you visually because the picture in terms of the waste in the way the fee for service system, particularly in Part B, works compared to risk contracting. So I just want to say there are tremendous opportunities if we keep our eye on something nobody else is focusing on.

The CHAIRMAN. We are going to have a hearing tomorrow in which you might want to do that.

Senator DURENBERGER. I will be there.

The CHAIRMAN. Can I make the point that I think is Senator Durenberger's point, that the administration proposes with the reforms that in effect health care costs in dollar terms will double in the next 10 years which Mr. Balmal might not be surprised to learn.

Senator Conrad?

Senator CONRAD. Thank you, Mr. Chairman.

I want to pick up on the point that Senator Durenberger was making because I do think he is talking about something that ought to be a central focus in this debate. We are at 14 percent of gross domestic product now in terms of health care. The projection is that we are going to go to 20 percent of gross domestic product by the year 2004 if we fail to act.

But even if we follow the President's plan we are going to go to 19 percent of gross domestic product. Most people are saying we are spending too much now at 14 percent of gross domestic product, far more than any of our major competitors. Nobody else is at more than about 9 percent of gross domestic product.

And yet we are talking about a reform proposal that takes us to 19 percent of gross domestic product, and that assumes the premiums caps. If you read the CBO study, they say the premium caps are the element of the President's plan which exercises the greatest amount of discipline on these exploding expenditures. And, frankly, I think the premium caps have very little chance of passing around here.

I wonder what the CBO analysis will be of this reform plan in terms of the part of GDP that will be dedicated to health care without the premium caps. We might be very close to the 20 percent—

$1 in every $5 in this economy going for health care by the year 2004—even with reform.

I think this is absolutely central to the issue. I know in my State we are number one in a lot of things. We are number one in hard red spring wheat. We are number one in the production of durham. We are number one in the percentage of our income going for health care, according to the Family USA study just out.

Mr. PANETTA. You are number one in cold weather, too.

Senator CONRAD. No. No. No. No. Minnesota takes that. We do not want any distortion on that record.

Let me just say, this concerns me greatly because the thing that I hear from the people in my State, only 9 percent do not have coverage in my State—9 percent. The national average is 15 percent; 9 percent in North Dakota.

The thing that they are talking to me about are these exploding costs that they are going to bankrupt families, they are going to bankrupt businesses. This is the fastest growing part of State spending. It is the fastest growing part of Federal spending, as your numbers reveal. And I am not sure we have a plan in front of us that really confronts that issue.

I salute the President for having a comprehensive plan and it is better according to CBO's analysis than staying the current course. But I am not certain any of them really address this cost explosion in a meaningful way.

That leads me to my next point, which is really what I want your reaction on, Leon. Again, I salute you for your presentation. I think your presentations, both before the Budget Committee and the Finance Committee, have been excellent. I would give you very high grades. I think you have been honest with us and I appreciate it.

Looking at debt held by the public in terms of our overall budget position, I am one who has not taken a position on the balanced budget amendment. Frankly, I would far prefer to balance the budget absent a constitutional amendment. I do not think that is the first choice.

But I may be left with voting for it because I just become convinced we are not going to do the job any other way. Debt held by the public, this chart—I do not know if you can see from there—but it shows from 1988 to 2004 and you can see because of the action we took last year, we have stopped the absolute explosion in debt held by the public. And actually, we are seeing some decline for several years in debt held by the public because of the action we took last year.

But then in about 1998 it starts back up again. That concerns me. I want to see debt held by the public as a percentage of our gross domestic product coming down on a steady basis. That is what I think most matters in economic terms.

I know the administration has said, well, health care reform will be a part of continuing the progress. When I think of going from 14 percent of GDP for health care to 19 percent of GDP for health care under the administration's plan, I really wonder, are we going to be reducing debt held by the public as measured against the size of our economy.

The CHAIRMAN. Can I just say by debt you mean all forms of debt?

Senator CONRAD. Yes. Well, I am talking now about debt held by the public, which, of course, excludes the Social Security trust funds, those funds that where we owe from one government account to another government account.

But I am wondering, what is your long-term projection with respect to debt held by the public even given the health care reform called for by the President. When we get into those out years, are we going to see the debt continue to come down or are we faced with this picture that I have from CBO?

Mr. PANETTA. Let me refer to a chart that staff just handed me. I will be happy to share this with you because it basically deals with Federal debt held by the public, the very area that you raise your question on.

Again, as a percent of GDP, it reflects that between now and even going into the early 2000's, we are looking at, if you look at 1994, the percent of GDP represented by the Federal debt is about 52.3 percent. It goes down in 1995 to 51.9 percent and continues on very much a downward trend through 2005, which shows about 47.6 percent of GDP.

Now, obviously, GDP is going up during that period of time. Your debt is rising from $3.4 trillion to about $5.7 trillion.

Senator CONRAD. But measured against the size of the economy——

Mr. PANETTA. But measured against the size of the economy——

Senator CONRAD. Your estimates are that debt held by the public will be in decline——

Mr. PANETTA. That is correct.

Senator CONRAD [continuing]. Through 2004.

Mr. PANETTA. 2005.

Senator CONRAD. I would very much like to get those numbers.

Mr. PANETTA. I would be happy to provide that.

Senator CONRAD. Then what is your outlook past that? I guess you do not have a project beyond that.

Mr. PANETTA. I keep asking staff, what is the look out there beyond 2005 and it becomes much tougher to project obviously.

Senator CONRAD. I tell you, I think this is terribly important. In economic terms, it is what really matters, is this debt compared to the size of the economy and that we have a very clear picture in this balanced budget amendment debate on what those numbers are, because it is certainly going to have an influence on my thinking about what I do here.

Mr. PANETTA. I understand.

Senator CONRAD. I thank the Chair for his courtesy.

The CHAIRMAN. No, thank you, sir, for your clarity. You would not want to share that table with us, would you? We could put it in the record.

Senator CONRAD. Sure. Yes.

The CHAIRMAN. We appreciate that.

The CHAIRMAN. Now, Senator Roth, you have been very patient, sir.

Senator ROTH. Thank you, Mr. Chairman.

Mr. Panetta, it is always a pleasure to see you. Now, before I came, I think you discussed in some detail the estimated fiscal year. If I sound like gravel, I apologize. Can you hear me all right?

Mr. PANETTA. Yes.

Senator ROTH. You estimated that the fiscal year 1995 deficit has dropped by $120 billion since your February 1993 estimate. As I understand it, you say that $83 billion comes from last year's budget bill. So I assume of that $120 billion, $40 billion, or roughly one-third of it, comes from re-estimates.

Mr. PANETTA. No. About $22 billion of that number would come from basically interest savings, either through lower interest rates, interest payments on the debt, or interest-related savings in programs, so we have estimated that about $22 billion is related to the reduced interest rates which we think were a result of the economic plan. About $21 billion is re-estimates. About half of that number then is re-estimates.

Senator ROTH. All right. Then of the remaining $83 billion, how much of the $83 billion is from taxes?

Mr. PANETTA. Half of that approximately is revenues and half of that is savings, spending savings.

Senator ROTH. How much is from the Defense budget, by dollars?

Mr. PANETTA. Of the one-half in spending, I would wager to say about $13 billion.

Senator ROTH. $13 billion savings from Defense?

Mr. PANETTA. Defense.

Senator ROTH. And how much is from non-Defense discretionary spending?

Mr. PANETTA. About $3 billion.

Senator ROTH. $3 billion of the total?

Mr. PANETTA. That is correct. You have entitlement savings then on top of that.

Senator ROTH. The Wall Street Journal says that domestic spending will actually increase by $11 billion to $227 billion, or a 5 percent increase. Any comment on that?

Mr. PANETTA. Again, the cap basically sets a level. Defense spending is going down below that cap. We project that if we move some of those savings, obviously, into the key investment areas that you would see some increase in the non-Defense discretionary side of the budget. As to whether that is the exact number, I can give you at least our numbers on that as well.

[The information appears in the appendix.]

Senator ROTH. One of my concerns is the impact of what is happening to our small business constituents. They are now stuck with having to pay retroactive tax increases for 1993, one-third of which will be due on April 15th, together with a quarterly payment for 1994 that could be, I gather, as much as 30 to 40 percent higher than the same time last year.

Then you have on top of that the administration's health care proposal, which will mandate that they pay 80 percent of the premium for health care insurance up to 7.9 percent of payroll. That is a pretty big payroll tax increase. Together with $5 billion more in self-employment taxes on Sub-S corporations and changes in the definition of independent contractors.

My question is: Out of the estimated $26 billion tax increase in the 1994 fiscal year, and $44 billion tax increase in 1995, how much of that money will come from returns filing with Subchapter S income, as sole proprietors, or as partnerships?

Mr. PANETTA. I will have to get you the answer to that question.

Senator ROTH. I would appreciate that, if we could have that.

Mr. PANETTA. Sure, Senator.

[The information appears in the appendix.]

The CHAIRMAN. And thank you for that, Senator Roth.

Senator ROTH. One further question is a question in connection with your job creation, comparing the job growth from 1988 through 1992, to 1993. I wonder if you could compare job creation from 1981 to 1988, the Reagan years, to the period since January 1992. And could you also compare by types of jobs, for example, part-time.

The CHAIRMAN. You mean January 1993, do you not?

Senator ROTH. Yes.

The CHAIRMAN. Distinguishing administrations.

Senator ROTH. Yes, that is correct. Thank you, Mr. Chairman.

Could you also give us that information? I assume you will want to do this in writing.

Mr. PANETTA. Sure.

Senator ROTH. The type of jobs, whether part-time, full-time, salary, nature of the jobs, too.

Mr. PANETTA. We would be happy to provide that.

[The information appears in the appendix.]

Senator ROTH. Thank you.

The CHAIRMAN. Thank you, sir.

Just a few concluding points. First to say that I am pleased to see that the President is addressing this whole question of Title I. Not to get into war stories, but I was the person who negotiated that matter in 1964 with the U.S. Catholic Conference and the Commissioner of Education and so forth. There was a sentence in the Democratic convention, the Democratic platform adopted in New Jersey at Atlantic City, it was agreed that that sentence went in the opposition to what was then called Federal aid, would be withdrawn by those who had been opposed because it would make it available to all schools and all children under the Constitution.

That was done under the Elementary and Secondary Education Act of 1965, was on President Johnson's desk in April. It was a big event for us. We finally got Federal education that was meant to be targeted to low-income neighborhoods and in the excellent process of legislation and now 435 such—I think it is about 400 different Districts. Is that right?

I know that Congressman Owens, Representative Owens, on the House side is very much concerned about this and you are going to try to help get this back into its original conception.

Mr. PANETTA. That is right, targeting. It is actually essentially.

The CHAIRMAN. It was intended to be targeted to the children in Districts that did not have the resources that others did.

Mr. PANETTA. Right.

The CHAIRMAN. For which we very much thank you.

On Social Security, it is hard to see that it really is on the radar screen of not just—I am not just thinking of the administration but of the department. For example, one of the real issues we have brought out there is the notch issue.

It may not concern citizens your age, but persons a little older than I. There are 7 million people or 6.5 million or so that really do feel they are being cheated.

Mr. PANETTA. My mother-in-law is one of them.

The CHAIRMAN. Your mother-in-law. Well, then you know about this. They feel strongly.

Mr. PANETTA. Very well.

The CHAIRMAN. And we feel otherwise, all right. But the Congress created by statute the Commission on the Social Security Notch Issue by statute in 1992. And the House has made the appointments, bipartisan—I mean, majority, minority. The Senate has made the appointments—majority, minority. There are no appointments for the administration.

Can I ask you, I mean, the people concerned—your mother-in-law—have a right to know what the government thinks on this subject. It has never stated anything. You cannot find anywhere where a basically impartial body has said, well, what are the facts here. You know some and I know some. But that is our story.

Is there any reason that these appointments have not been made?

Mr. PANETTA. I am not aware of the fact that the appointments were not made, but it is something I will check on.

The CHAIRMAN. For 1 year and ready to be a year and a quarter we have been saying, can you not do this. And the answer is, when we get around to it. We have other more important things to do. I do not think there is anything that much more important than addressing a feeling that 7 million people have, which is being, you know, stimulated. I do not have to tell you about that.

Will you ask about that?

Mr. PANETTA. I certainly will.

The CHAIRMAN. There is one other thing. If there is one subject that has troubled this administration and troubled our Congress, it is the question of the payment of Social Security contributions for domestic service.

These are women who clean other people's toilets. All right. If Francis Perkins had a group in mind that she would want to be covered by retirement benefits, by disability benefits, it is people, you know, women who work by the day in other people's houses. And only a quarter of them are now covered. Now give payments such that through time they have a retirement benefit.

A year has gone by and we have not got a single proposal from the administration to do anything about this. I do not have to say, and I do not want to raise matters which are painful for everybody. But, you know, the administration appointment process began in 1993 with an Attorney General nominee who had to withdraw because of that problem and ended with a Secretary of Defense nominee who felt he had this, had this problem and Admiral Inman said he would be in touch with Mr. Rostenkowski and me about this.

That is good. He on his own is saying this. Where is the department, where is the Social Security Administration?

Could I make this point, sir? We have a good bill up here. But we need $100 million in that bizarre way, even though this bill will increase collections vastly, on one calendar year it will slow them down. It is not a lot of money but it would have been so reassuring to have the administration say, yes, we care about this.

These are women who work in other people's houses. They work by the day and the law says that Social Security benefit contributions should be paid by them and for them. Our proposal is very simple, which is you now treatment domestic employment as if you were a business and you had these employees and you fill out quarterly forms and they go to five places, and they have seven pages, and it does not happen. Three-quarters of the persons who are entitled to coverage do not get it.

We would simply move this to an annual payment on the 1040 that says have you engaged anyone. And if you have engaged someone who has earned—if you paid someone $610 in that calendar year, that gives you a quarter of coverage. That gives that person one-quarter of coverage under the Social Security system and so you pay the benefits on your 1040; and when you have had 40 quarters you are covered, you are vested and you are a member of the system. That could happen, you know, in 10 years.

We think it is a good bill. There may be a better one. We indexed that $610, so each year it is whatever gets you a quarter of coverage. We have had no sound—we heard no sounds from the administration, as if they did not know there was such a problem.

Mr. PANETTA. Senator, I think the administration would be sympathetic towards trying to get the reforms that you are talking about in place. Let me talk to my colleagues at both HHS and Treasury to see if we can get you it.

The CHAIRMAN. We are scrounging around to find this nominal $100 million. Clearly revenues will grow, almost immediately. But you have the 1 year of quarterly payments. Now that is getting yourselves tied up in procedural matters that defy public policy. Will you do that?

Mr. PANETTA. I sure will.

The CHAIRMAN. And one other thing. You were very good to say that the ISTEA, the Intermodel Surface Transportation Efficiency Act, will be fully funded. But actually, sir, in your testimony it says, "infrastructure, full funding of the core highway programs. Under the Intermodal Surface Transportation Efficiency Act, a substantial"——

Well, may I say that the whole thesis of that legislation was that we have built those highways and that the effort to deal with automobile congestion by expanding capacity it never worked. You filled up those two extra lanes just as quickly. You had to talk up pricing. You had to talk alternatives. We had finished the interstate highway system.

There is a tendency down—the Department of Transportation was created to build the interstate and defense highway system. I remember I wrote the—in 1960 in the Democratic—in the Presidential election of that year, the American Automobile Association sent a questionnaire to both the candidates about this matter basically. I was asked to draft the response for Senator Kennedy and it was pretty much unchanged. It was sent out to the AAA.

It said we need a Cabinet Department to really do this job, which was the largest public works program in history. But we did it. We did it very badly in cities. And at the time it was our view that it was going to be done badly and it was going to wreck, just open the cities because you just could not put these massive highways through cities without doing that and then disbursing industry to the surround.

It has had huge consequences. One of which is, it has made mass transit much more important in cities than even it was.

You speak of welfare reform. You know, the people who will get jobs under welfare reform will get to those jobs on the subway or the bus. They will not get into their car and drive downtown. And mind you, major cities such as ours, yours, you know this, we depend on mass transit.

ISTEA, Intermodel, was meant to not just fund highways. It said enough of that. Is there any hope that we can get the fully funding for the transit aspect of ISTEA?

Mr. PANETTA. Again, in the budget we were working with, the Secretary of Transportation recommended this emphasis on the capital side versus the operating side. Although I think as I have often mentioned, it needs to be weighed with the whole thrust of the ISTEA debate and where it focused.

I think the room is there. I think the room is there to try to provide additional resources.

The CHAIRMAN. The room is there.

Mr. PANETTA. Absolutely.

The CHAIRMAN. Good. I am going to try to get this in appropriations.

I make one point to Secretary Panetta, which I think you would agree, that when you say we will put all our emphasis into capital, as against operating expenses, well, what does that do to the system that has just had a major capital drive? As for example, I will just be open about it, we have done in New York City, the tax code and other things, to put a lot of new capital in.

But the operating subsidy is still at issue. It seems like a subsidy to individual riders, but those highways are subsidies. And getting an optimal arrangement is important to the efficiency of a metropolitan economy. You agree on that.

Mr. PANETTA. Yes, sir. I want to assure you that I always felt this was an area where if we could focus again on these priorities that the flexibility is there to make the kind of adjustments you are discussing.

The CHAIRMAN. Which is why we put that into the bill.

Mr. PANETTA. Correct.

The CHAIRMAN. Well, sir, is there anything else we agree on? This has been very generous of you—with your time, with your information. I, for one, congratulate you on this budget. I, for one, want to say that I think Senator Dole was right, that this process started in 1990, but it was your budget, basically the budget reconciliation in 1993 and your budget this year that clearly marks the change in direction of American and the fiscal policy of the Federal Government after reaching a point of alarm.

You are moving in very good shape. Thank you. You would not want to just introduce your colleagues behind you who have been——

Mr. PANETTA. Absolutely. They are my audience here.

The CHAIRMAN. They want to remain anonymous so no one will catch them.

Mr. PANETTA. Let me introduce them because they do a lot of work. They do not get the recognition they deserve often times. John Angell, who is——

The CHAIRMAN. Mr. Angell, good morning, sir.

Mr. PANETTA [continuing]. One of my aides there. Martha Foley who handles the legislative side.

The CHAIRMAN. She was working our computer before you even arrived. She came in and took over our computer.

Mr. PANETTA. Belle Sawhill, who is involved with the human resources.

The CHAIRMAN. And to whom we look forward for a welfare legislation on April 2.

Mr. PANETTA. Barry Anderson, who heads up the budget side in terms of the numbers.

The CHAIRMAN. Mr. Anderson, welcome, sir.

Mr. PANETTA. And Barry Toiv, who does my press work there at the Office of Management and Budget. He has been with me a long time, when I was in Congress.

The CHAIRMAN. You are very welcome, sir.

And, again, thank you very much. We will look forward—remember, do not forget, you have to find us some money for the GATT.

Mr. PANETTA. And everything else.

The CHAIRMAN. And everything else.

[Whereupon, at 11:53 a.m., the hearing was adjourned.]

APPENDIX

ADDITIONAL MATERIAL SUBMITTED

PREPARED STATEMENT OF SENATOR CHARLES E. GRASSLEY

The administration has recently released its FY 1995 budget which shows a very rosy scenario regarding the deficit.

Unfortunately, just like a rose, the bloom has faded quickly and the petals are falling on the administration's projections regarding deficit reduction.

In the past few days since the release of the budget, several events have taken place that will substantially increase the deficit beyond the administration's projections.

These include:

—CBO has estimated that the Administration's health proposal will cost $74 billion over the next five years, not save $59 billion as the administration suggested. So that's a $133 billion increase in the deficit.
—There is a gap of over $20 billion between the administration's defense budget and the pentagons' plans.
—GATT is projected to cost $11 billion over five years in lost tariff revenue.
—The emergency supplemental added nearly $8 billion to the deficit.
—Superfund restructuring is estimated to cost $3 billior
—Interest rates on treasury bills have increased markedly from the administration's estimates. The administration estimated 10 year t-bills to be at 5.8% for the next five years. The 10 year t-bill is already over 6.0% and climbing.

On top of this we still haven't gotten the bill for:

—Department of Labor's Workforce Security Act or
—Welfare reform.

The rosy scenario for the deficit is gone. We need to make further efforts now to cut the deficit.

PREPARED STATEMENT OF LEON E. PANETTA

Mr. Chairman, Senator Packwood, Members of the Committee, as always it is a pleasure to appear before you. I am here today to discuss the President's fiscal year 1995 budget, which he transmitted to the Congress on February 7. A copy has been provided to every Member, and I hope that you and your staffs have found it useful.

The President's 1995 budget builds on the very strong foundation for long-term growth and prosperity that we established together last year with the adoption of the President's economic plan. The budget emphasizes continued fiscal discipline and spending cuts, both to follow through on deficit reduction and to finance targeted public investments in long-term economic growth.

In November, 1992, the American people sent a clear message that they wanted to reverse the budget and economic policies of the past, which had produced huge deficits and a stagnant economy. President Clinton has carried out that mandate.

With his economic plan last year, and with this budget, President Clinton has set a new path for the future. Instead of rising deficits, we have shrinking deficits. Instead of tax unfairness,. we have a tax system that, according to the Congressional Budget Office, is more progressive than at any time in at least 17 years. Instead of ignoring our future, we are investing to improve long-term economic growth and to make today's workers and our children more productive. And finally, the numbers are real -- no rosy scenarios, no gimmicks, no smoke and mirrors. What you see is what you get.

FISCAL DISCIPLINE

Deficits

This budget preserves the $500 billion in deficit reduction that Congress and the President enacted in 1993 with the Omnibus Budget Reconciliation Act (OBRA-93). It sticks to the spending caps established last year. It produces the lowest deficit as a percentage of GDP in 15 years, since 1979. And it produces declining deficits for three straight years. The Congressional Budget Office essentially has confirmed these numbers.

The budget deficit, which was $290 billion in 1992 and $254.7 billion in 1993, is projected to fall to $234.8 billion in 1994, and $176.1 in 1995. That would be three declines in a row in over 40 years -- for the first time since Harry Truman was President. As the President said in his State of the Union address, today the buck stops here.

Another way to see the decline is to look at projected deficits. The 1995 deficit was projected at $302 billion before the President's plan was enacted. The $126 billion drop to $176 billion represents a 40-percent cut in the deficit. That cut is due primarily to two factors. The specific deficit reduction measures contained in OBRA-93 are responsible for $83 billion, or about two-thirds, of that total. The improved economic outlook is responsible for another $22 billion. That includes $12 billion from economic changes, largely lower interest rates, and $10 billion from reduced deposit insurance outlays, also due largely to lower interest rates.

As a percentage of GDP, which measures the size of the deficit relative to the economy, the deficit declines from 4.9 percent in 1992 to 4.0 percent in 1993, and 2.5 percent in 1995. Without enactment of the President's health care plan, it flattens out at 2.3 percent through 1999. But with the plan's enactment, it falls to 2.1 percent by 1999. This is a sharp contrast to the previous four years, when deficits as a percentage of GDP rose considerably.

In your letter of invitation, Mr. Chairman, you specifically asked for a report on the progress of OBRA-93. When the Administration first proposed our economic program, we projected that the results would be a 1993 deficit of $319 billion -- equal to 5.4 percent of the GDP -- falling to $262 billion (4.0 percent) in 1994, $242 billion (3.5 percent) in 1995, $205 billion (2.9 percent) in 1996, and $206 (2.7 percent) in 1997; then rising to $241 billion (3.1 percent) in 1998, because of rapidly rising health-care costs. We forecast that ten-year Treasury note rates would decline steadily from 6.7 percent in 1993 to 6.4 percent in 1998, aiding deficit reduction. Many said at the time that these projections were overly optimistic.

However, actual economic and budget performance has far exceeded the Administration's projections. Long-term interest rates fell dramatically from the first indications that the President would present a truly credible deficit-reduction program, with the ten-year Treasury rate at 5.9 percent in 1993; and the interest-sensitive investment sectors of the economy rebounded. As a result, the 1993 deficit was only $255 billion, or 4.0 percent of GDP. For fiscal year 1994 -- already almost half over -- the deficit is projected at $235 billion (3.5 percent). If the economy and the budget stay on track, the 1995 deficit will be $176 billion -- $66 billion below our original projection under the assumption of adoption of the President's economic plan. At 2.5 percent of the GDP, the 1995 deficit is projected at only about half of the actual 1992 level, and is also below our original projected low point for the deficit -- the 2.7 percent figure for 1997.

According to current projections, the deficit will remain below $190 billion through 1998, and will fall to 2.3 percent of GDP in 1996, even without the President's health-reform program. With health-care reform, we project that the deficit will fall to 2.1 percent of GDP by 1999. This far exceeds the Administration's original projections for deficit control.

As the Congressional Budget Office stated in its January report on the budget outlook, "...the deficit picture is significantly brighter than it appeared one year ago...The dramatic improvement since last January is largely the result of the enactment in August of a major package of tax increases and spending cuts -- the Omnibus Budget Reconciliation Act of 1993."

Spending cuts

Regarding spending cuts, the budget sticks to the spending caps, which freeze outlays at 1993 levels. Indeed, discretionary outlays fall by nearly $8 billion from 1994 levels. Seven out of 14 departments are cut below the 1994 enacted level, in budget authority or outlays, or both.

Some 300 programs are cut below the 1994 enacted level, including more than 100 which are actually terminated.

Federal employment is reduced by 118,300 from the beginning of 1993, exceeding the President's executive order requirement by 18 percent and putting us ahead of schedule for achieving the 252,000 reduction recommended in the National Performance Review.

To give an example of the austerity of the spending freeze, over the next five years it will take $221 billion in cuts from baseline to meet the spending caps.

Here again, there is a stark comparison to the previous 12 years. Annual federal spending as a percentage of GDP is going to be lower than it was in those years.

The spending cuts are in the following areas:

- Managing government for cost-effectiveness and results. Savings include the reduction of Federal personnel levels by 118,300, the procurement reforms recommended by the National Performance Review, and the elimination of 1,200 Department of Agriculture field offices.

- Better targeting of government grants. Savings here include Low-Income Home Energy Assistance (LIHEAP), a reduction of $707 million from 1994, which will permit us to better target the program to areas of the greatest need; Transit Operating Subsidies, a reduction of $202 million in a program that is more appropriately financed at the local level that will help us to increase by $650 million capital transit subsidies, which we believe are a more appropriate use of Federal funds; and public housing savings of over $2 billion, in an area where there is $8 billion in the funding pipeline already, permitting us to make significant investments in housing vouchers and aid to the homeless.

- Reductions and terminations of low-priority programs. The budget terminates over 100 programs, including oilseed export subsidies, portions of the impact aid program, most of the Education Department programs recommended for repeal by the National Performance Review, and NASA's long duration orbiter. The programs also include such low-priority programs as the Beluga Whale Committee and the Center for Shark Research. We think it makes sense in some programs not just to reduce spending but to end it entirely.

• Defense savings following the end of the Cold War. The downsizing of the defense budget that began in the mid-1980's and which President Bush accelerated following the end of the Cold War is continuing in this Administration. However, the President will not accept any further reductions beyond those we proposed last year.

• Requiring payment for government services. Finally, while this budget contains no new tax increases, other than the taxes contained in the health care reform plan, it does contain some fee increases. One example would be the increased gun dealer licensing fees announced by Secretary Bentsen in order to help curb the gun violence on our streets.

INVESTMENTS

While about two-thirds of the spending cuts -- $17 billion in outlays -- will be used to fulfill the deficit reduction we required last year, the other one-third -- about $8 billion in outlays -- will finance nearly $14 billion in budget authority for targeted investments in the future of our economy and our people.

Those investments are in research, technology, and infrastructure to spur economic growth and create more and higher-paying jobs; in education and training to make our children and workers more productive and prepare them to hold those jobs now and in the future; in the environment; in health security; and in fighting crime.

Investments in the budget include the following:

Technology and research: the Commerce Department's National Institute of Standards and Technology (NIST), the information superhighway, the Defense Department's Technology Reinvestment Program and other defense conversion dual-use technology programs, energy conservation research and development, NASA's Mission to Planet Earth, and National Science Foundation research and education.

Overall for technology and research investment programs, there is a $1.4 billion, or 22-percent, increase over 1994, and a 50-percent increase over 1993.

Infrastructure: full funding of the core highway programs under the Intermodal Surface Transportation Efficiency Act (ISTEA), a substantial increase for mass transit formula capital grants, and the Department of Agriculture's rural development initiative.

For infrastructure investment programs, there is a $1.3 billion, or 6-percent, increase, a 21-percent increase from 1993 (not including a $1.7 billion increase in rural development loans.

Education, other children's programs: substantial investments for Head Start, Title I for disadvantaged elementary students, Goals 2000 for elementary and secondary school reform, the school-to-work apprenticeship program for non-college-bound high school students, and national service to allow more young people to serve their communities and earn money toward college, and a significant increase for the WIC nutrition program for pregnant women, infants, and young children.

Training: the President's Workforce Security initiative to provide a new reemployment system, a significant expansion of the Job Corps, and a one-stop career shopping initiative.

For education and training investments, the increase is $3.3 billion, or 24 percent, from 1994, 43 percent from 1993.

Environment: the climate change action plan in the Department of Energy, natural resource protection and environmental infrastructure in the Interior Department, and the Environmental Protection Agency's clean water and safe drinking water State revolving funds.

For environmental investments, the increase is $1.4 billion, or 24 percent, from 1994, 32 percent from 1995.

Health security: a record request for the National Institutes of Health, continued additions for the Ryan White Act, childhood immunizations, and drug treatment.

For these programs, which are separate from the President's health care reform plan, there is an overall increase of $1.3 billion, or 10 percent, over 1994, or 20 percent over 1993.

Crime: an additional $2.7 billion in 1995, most of which is for the community policing initiative, the President's pledge to put an additional 100,000 police on the nation's streets; in addition, there are funds to implement the Brady bill, to establish the community partnerships against crime program in the Department of Housing and Urban Development, and a major initiative to tighten border security and slow down illegal immigration.

Defense/National Security

The budget reflects the President's commitment to permit no further reductions in defense spending beyond those proposed last year. This will ensure that our armed forces remain the world's best equipped, best trained, and best prepared fighting force.

MATTERS OF PARTICULAR CONCERN TO THE COMMITTEE

In your letter of invitation and in subsequent communications, Mr. Chairman, you also requested that I comment on a number of issues of particular concern to this Committee.

Budget of the Department of the Treasury

The Administration proposes a Treasury operating budget of $10.4 billion for 1995. This will actually support a program level of $10.6 billion, because user fees and reimbursements will offset the cost of some services provided to specific benefitting groups. This is an increase of $262 million over 1994. The total proposed 1995 Treasury staff level is 157,700 full time equivalent positions, a decrease of over 3,500 positions from 1994. Most of this reduction occurs in the Internal Revenue Service.

Included as major increases are $295 million for the IRS Tax System Modernization, a Presidential investment item. The Bureau of Alcohol, Tobacco and Firearms budget proposes a $6 million increase for implementation of the President's anti-violent crime firearms initiative. The Customs Service budget proposes $26 million for automation of import trade activities, and $25 million for enhanced NAFTA-related enforcement of trade laws. These funds are part of the Administration's commitment to open and fair international trade.

The budget proposes a decrease for the Customs Air and Marine Interdiction program of over $57 million. The administrative savings, aircraft and marine vessel cuts, and flight hour reductions will be realized without diminishing the effectiveness of the interdiction programs. These changes are consistent with the shift in emphasis from counter-drug operations in the transit zones to host country operations. Also, care has been taken to ensure that decommissioned aircraft and boats remain available should drug trafficker activity require increasing the level of program resources. Also, $32 million in savings from the Treasury Forfeiture Fund are proposed. These reductions provide funds to meet other Treasury program priorities.

With specific regard to the IRS, the Administration is committed to aggressively supporting tax administration and the operating budget of the Internal Revenue Service (IRS). The $295 million increase for the Tax System Modernization (TSM), a large-scale and comprehensive updating of IRS's information systems, is for a project strongly supported by the President that has already produced significant productivity savings and will create further benefits, including paperwork burden reduction.

The Administration is also interested in pursuing a large compliance initiative to reduce the budget deficit. This initiative would cost $405 million in 1995 and fund approximately 5,000 full time equivalent positions. Over a five-year period, this initiative will generate new revenue far in excess of its cost. The revenues produced by this initiative will not be used to offset new spending but to lower the deficit. We would like to seek special budgetary treatment for the initiative similar to that afforded the 1991 compliance initiative, which received a discretionary spending cap exemption. We will work with Congress to identify a specific treatment for this initiative. For this reason, we have not included the initiative in the President's budget itself.

The President's Budget does include significant changes in the personnel levels of IRS. The proposed staffing level is over 111,100 positions, a reduction of just under 3,200. Most of this decrease is due to TSM productivity savings and the Executive Order on personnel reductions. To ensure that collection of tax receipts is protected, no Executive Order reductions are being taken in Tax Law Enforcement. Additional reductions result from labor cost patterns, which represent a trend toward a more experienced, better skilled and higher compensated workforce. This reduction produces a realistic portrait of what we expect in the IRS budget.

Budget of the Department of Health and Human Services

The 1995 budget increases HHS discretionary funding by three percent, including a ten-percent aggregate increase for a cluster of high priority programs. Key priorities include:

o Ryan White Act HIV/AIDS Treatment ($93 million in budget authority over 1994 enacted level);

o Childhood Immunizations ($360 million);

o National Institutes of Health ($517 million);

o Treatment for hard core substance abusers ($284 million);

o Head Start ($700 million); and

o Social Security Administration Automation and Disability Investments ($565 million).

Reductions in lower-priority areas include:

o Low Income Home Energy Assistance Program ($707 million in budget authority below 1994 enacted level);

o Community Services Programs ($29 million less); and

o Health Professions Curriculum Assistance ($15 million less).

The 1995 budget proposes to consolidate over 25 categorical health professions programs into five consolidated grant programs. These consolidations will continue Federal support, assuring that the necessary primary health care professionals are available to meet the American people's needs while increasing grantee flexibility and providing administrative savings.

The HHS budget reduces FTE levels by 549 (1994 to 1995). FTE waivers for HHS, however, will allow the Food and Drug Administration and the Social Security Administration to increase their FTE levels in 1995 to 9,693 (+323) and 65,232 (+302), respectively.

THE PRESIDENT'S PLAN IS WORKING

The President's plan for reducing deficits and increasing investment is working. The President's commitment to reduce deficits helped to bring down long-term interest rates last year by over a full point. Those low rates are the primary engine driving the strong and stable economic recovery.

In the first year of the Clinton presidency, nearly 2 million jobs were created. Some 1.7 million were in the private sector, 70 percent more than in the years 1989 to 1992. The rate of unemployment fell from 7.3 percent at the end of 1992 to 6.4 percent at the end of 1993.

The economy grew at a rate of 2.9 percent during 1993. During 1989-1992, it grew at a rate of 1.4 percent. And we believe that the conditions are in place for an extended period of sustained economic growth -- 3 percent in real terms during 1994, gradually leveling off to 2.5 percent in 1999.

The housing market is experiencing a strong recovery, millions of families have effectively added hundreds of dollars to their pocketbooks each month by refinancing their mortgages, and business fixed investment in equipment -- a key measure of future growth -- grew eight times faster during 1993 than from 1989 to 1992.

Finally, continuing low inflation -- the Consumer Price Index increased during 1993 at the lowest rate since 1986, and the GDP deflator at the lowest rate since 1964 -- means that we have laid the groundwork for a strong, steady recovery.

To quote Federal Reserve Chairman Alan Greenspan, "The actions taken last year to reduce the federal budget deficit have been instrumental in creating the basis for declining inflation expectations and easing pressures on long-term interest rates. Although we may not all on agree on the specifics of the deficit reduction measures, the financial markets are apparently inferring that, on balance, the federal government will be competing less vigorously for private saving in the years ahead.

Chairman Greenspan continued, "Partly because of these structural adjustments, the foundations of the economic expansion are looking increasingly well-entrenched."

THE FUTURE

With regard to the future, the President's health care plan would bring the deficit as a percentage of GDP down to 2.1 percent by 1999. However, we don't have a chance to bring the deficit/GDP ratio down further without the President's health care plan. Health care is the most significant source of increased Federal spending in the future. Indeed, this is the only major area of spending that is growing faster than the economy. Health care reform is needed not only to provide health security to every American but to control costs for families, for businesses, <u>and</u> for government.

The Federal elements of the health care plan are fully described in the budget documents, and the numbers in the document fully reflect the impact of the plan on the budget. And the budget for HHS health-related programs anticipates the enactment of the President's Health Security Act (HSA). This legislation will be the most far reaching restructuring of national health policy in our history.

The President's budget includes proposals for reductions in Medicare spending of $118 billion and in Medicaid spending of $61 billion over six years. These proposals are a part of a larger strategy designed to bring current Federal programs into conformity with the new health insurance system that will result from the HSA. In addition, they will provide savings that will help to offset the additional spending for new benefits such as prescription drugs and home and community based care.

The Health Security Act also proposes $1.1 billion in 1995 for a variety of public health initiatives designed to build service capacity and increase access to health services as health insurance becomes available to all Americans. If enacted, this funding request would be in addition to the $21.4 billion budgeted for public health in the 1995 budget.

There are other mandatory issues that we will address this year.

The first is welfare reform, a top priority for the President. We intend to present a legislative proposal that will: (1) promote parental responsibility to reduce the need for welfare; (2) reward work, not only through the Earned Income Tax Credit but by ensuring that workers have health insurance and child care; (3) substitute work for welfare by providing job search, education, and training, and expecting recipients to work by the end of two years; and (4) reform government assistance to reduce bureaucracy, combat fraud and abuse, and give states greater flexibility. The plan will be fully paid for.

Likewise, the legislation to implement the GATT trade treaty will be sent to the Congress with the revenue losses fully offset. We plan to work with the Congress on a bipartisan basis on the elements of that legislation, as we did prior to the adoption of the NAFTA legislation, to ensure that the legislation is adopted in the fast-track framework.

Regarding entitlements generally, in August, 1993, the President signed an Executive Order on mandatory spending (Executive Order No. 12857). This order established procedures to set targets for mandatory programs (excluding deposit insurance and net interest) for 1994 through 1997. The targets are adjusted each year for increases in beneficiaries and changes in receipts in legislation enacted after OBRA 93. If the targets are exceeded, the Order requires Presidential recommendations to address the overage. The House has instituted new rules to respond to the President's recommendations.

As shown in the 1995 budget (Analytical Perspectives, pp. 203-208), the initial target for 1995 was $784.7 billion. Adjustments allowed under the order have resulted in a revised 1995 target of $792.7 billion. Estimates of 1995 outlays under current law stand at $774.7 billion, or some $18 billion below the target. The estimates for the other covered fiscal years (1994-97) are also below the adjusted targets. At present, therefore, none of the targets are exceeded, so responses required by the order in case the targets are exceeded have not been triggered.

Finally, with regard to the future, we know that entitlement programs need to be examined further to see if there are additional savings that can be accomplished. The President's Bipartisan Commission on Entitlement Reforms, to be headed by Senators Kerrey and Danforth, will give us an opportunity to study these issues more carefully and consider possible reforms.

Balanced Budget Amendment

Unfortunately, some seem to think that the answer to all of our future budget problems is to adopt a Constitutional amendment requiring a balanced Federal budget.

As the President stated in his letter to the House and Senate leaders of November 5, 1993, the Administration is firmly opposed to the proposed balanced budget constitutional amendment, S.J. Res. 41, and its companion measure, H.J. Res. 103. The President stated: "While I am deeply committed to bringing down our Nation's deficit, this proposed balanced budget amendment would not serve that end. It would promote political gridlock and would endanger our economic recovery."

Congress and the Administration have already made -- and can continue to make -- tough decisions to reduce the deficit without S.J. Res. 41. S.J. Res. 41 makes no direct effort to deal with the principal sources of the deficit. It does not reduce mandatory budget items, or restrict discretionary spending, or change tax rates. Last year we enacted a law that does reduce the deficit -- by $504.8 billion over 5 years. No constitutional amendment was necessary for that to happen. That law contained real spending cuts in both mandatory and discretionary programs, and real tax increases largely on the wealthy.

The plan is working. Again, the 1995 deficit is forecast to decline by 40 percent, from a projected $302 billion to $176 billion. We also hope to enact health care reform that controls the rising cost of health care programs. These are specific, credible steps to reduce the deficit.

CBO has stated that $600 billion in additional deficit reduction would be necessary to meet the balance requirement by 1999 -- yet the supporters of S.J. Res. 41 have never come forward with a $600 billion package of taxes and spending cuts to achieve the balance they say they want. The amendment is simply a gimmick that allows supporters to say they are for a balanced budget without ever having to make the hard choices necessary to actually -- not rhetorically -- reduce the deficit.

S.J. Res. 41 would also undermine respect for the Constitution. The Constitution is not a bookkeeping manual. If it is adhered to, the amendment would threaten to turn recessions into depressions, forcing us to raise taxes and cut spending whenever a weak economy is causing deficits to rise. If it is not adhered to, or it is evaded through gimmicks and manipulation, the Constitution will have been degraded. In either case, the Courts will be invited to become arbiters of the national budget. This is a role they are not suited to play, and, in a democracy, they should not play.

Finally, S.J. Res. 41 is overly rigid -- far more rigid than State balanced budget requirements. Most States with "balanced budget" requirements actually allow deficit financing -- usually for capital expenditures. In 1990, the States increased their borrowing by over $40 billion. S.J. Res. 41 requires balance in the entire federal budget -- no new debt financing is permitted. S.J. Res. 41 is so rigid that any unpredictable event -- a disaster or international crisis -- would render the most powerful nation on earth helpless -- or at the mercy of a minority in Congress, who could block the three-fifths vote needed to respond to the crisis. Majority rule is fundamental to the Constitution -- but S.J. Res. 41 would allow a minority to govern over basic fiscal and budgetary policies of the country.

CONCLUSION

Mr. Chairman, we have spent a lot of time over the past several years working to reduce deficits, to slow the growth of spending, and to restore the future of our children and grandchildren. The plan the Congress and the President adopted last year is finally doing that. We need to stay on course with that plan, and we need to enact health care reform. I look forward to working with you as you work on your budget resolution and as we confront the challenges facing us in the year ahead.

Again, thank you for having me here. I will be happy to respond to your questions.

RESPONSES OF LEON E. PANETTA TO QUESTIONS SUBMITTED BY SENATOR GRASSLEY

1) *Mr. Panetta, you were quoted on February 4 in the Daily Tax Report of the Bureau of National Affairs as saying that the Clinton Administration plans to treat health care reform legislation as a form of reconciliation. What did you mean exactly? You didn't mean a reconciliation bill in the sense of strict limitations on debate, or being subject to the Byrd Rule, did you?*

I did not mean 'reconciliation' in the strict sense of limitations on debate or Byrd Rule constraints. Rather, I meant that health care reform legislation, like reconciliation, will require action by numerous House and Senate committees before it reaches either floor for a vote; it will need to reach the floor as a single legislative vehicle that combines various elements of the bill reported out of committee.

2) *The President's budget assumes further reductions in Medicare Part A reimbursements to hospitals, including a reduction in the annual update for hospitals by two percent between 1997 and 2000.*

All our Iowa hospitals lose money on Medicare. But perhaps the most seriously affected by any reductions in the hospital updates will be our Medicare Dependent Hospitals. Some 45 hospitals in Iowa are eligible to participate in this program. Some 30 get extra money through the program.

According to our hospital association, the elimination of the urban-rural differential in October of this year will not make up the revenue lost through phasing out of the Medicare Dependent Hospital program. This latter was assumed when Senator Dole and I introduced legislation to phase the program out in 1992. The legislation in question was included in OBRA 1993.

So, many of these hospitals could be driven out of existence by further across-the-board reductions in the hospital update. This could greatly reduce access to health care in the affected communities.

Other states represented on this Committee could well face the same situation.

Has the Administration considered the situation of these hospitals? And, in your view, would the Administration be willing to consider an extension of the Medicare Dependent Hospital program to help keep these hospitals going at least until they could make the transition into a modified role in their communities?

The Administration is well aware of the difficulties in providing health care services in rural areas. It was with this in mind that the Administration included a rural health initiative in its FY 1994 budget. OBRA 93 included a provision to extend rural health demonstrations through July 1, 1997 -- well into the proposed implementation timeframe of the Health Security Act. We believe that the extension of these demonstrations will assist rural health providers in adapting to a new health care system.

In addition, a critical rural hospital component in the Health Security Act is the "Payments to Hospitals Serving Vulnerable Populations" (sections 3481 - 3484). The Act creates a new entitlement that authorizes $800,000,000 per year for those hospitals that serve large low-income populations. Many of these targeted hospitals are rural hospitals.

The Act also authorizes network planning grants to help hospitals and other health care providers to organize new delivery systems. The Administration will work with the Congress to ensure access to health care services for Americans living in rural areas.

As you know, the Medicare Dependent Hospital (MDH) program was created in OBRA 89 to help certain rural hospitals close the inpatient payment gap with most other hospitals.

MDH-subsidized hospitals have generally faced negative profit margins and relatively few privately insured patients. These hospitals would find a more sustainable environment under the Health Security Act for several reasons:

- as you noted, the Medicare inpatient urban/rural payment differentials will be eliminated starting in FY 1995, increasing payment per discharge. The President proposed the extension of MDH payments in his FY 1994 budget, adopted in OBRA 93, to ensure that these hospitals were supported until the differential was eliminated;

- the Vulnerable Populations Adjustment (mentioned above) will increase the payments for rural hospitals in general, and

- these hospitals will be able to collect appropriate payment from all patients' insurance plans under the HSA's universal coverage design.

The MDH adjustment met a specific need at a difficult time for these hospitals. These hospitals now face a healthier future through both the proposed dedicated assistance proposed in the HSA and better private payment through universal coverage.

WILLIAM V. ROTH, JR.
DELAWARE

104 HART SENATE OFFICE BUILDING
TELEPHONE 202-224-2441

United States Senate

WASHINGTON, DC 20510

COMMITTEES
GOVERNMENTAL AFFAIRS
FINANCE
BANKING, HOUSING AND URBAN AFFAIRS
JOINT ECONOMIC COMMITTEE

March 9, 1994

The Hon. Leon Panetta
Director, Office of Management and Budget
Executive Office Building
Washington, D.C. 20503

Dear Mr. Panetta:

I want to thank you again for your testimony before the Finance Committee on February 23, 1994 on the President's Budget for Fiscal Year (FY) 1995. It is always a pleasure to welcome you.

I am writing this letter as a follow-up to that hearing. As you know, there were several questions that I asked, and you offered to provide me with written responses for the hearing record. I would like to outline those questions in this correspondence.

First, I asked a question regarding the change in your estimates for the FY 1995 budget deficit. That estimate has been reduced by about $120 billion since your February 1993 estimate. I asked for an itemization of the $120 billion figure. You stated that about $83 billion is the result of the 1993 budget reconciliation bill -- about half taxes and half spending reductions. You said about $13 billion is from Defense and about $3 billion is from non-defense domestic discretionary spending. You offered to provide me with more details on this, and to explain a Wall Street Journal article citing an $11 billion increase to $227 billion in non-defense discretionary spending. I would appreciate a detailed explanation of this, and a table outlining changes in your FY 1995 deficit. Attached is an example of items to list, and a format for the chart. Please provide as much detail as possible regarding these changes in your estimates, and summarize the items and amounts that were the result of the 1993 budget reconciliation bill.

The second question you offered to provide a written response for related to tax increases on small business owners. More specifically, my question was: out of the estimated $26 billion tax increase in FY 1994 and the $44 billion tax increase in FY 1995, how much of that money will come from returns filing with income from Subchapter S corporations (schedule E), sole proprietorships (schedule C or F), or partnerships (schedule E)? Also, how many taxpayers are there under this definition of small business, and how many will have to pay any increase in taxes as a result of the 1993 budget bill?

Finally, my last question asked you to modify your chart on job growth to compare the Reagan Administration years to the Clinton Administration years. Your chart had instead compared the Bush Administration years to the Clinton Administration years. I also asked that you compare by types of jobs, including, are they part time or full time, what are their comparative wage levels after inflation, what kinds of industries are the jobs coming from? I think it would be helpful to have that information.

Again, I want to thank you for your testimony before the Finance Committee and thank you in advance for responding to my questions from that hearing.

Sincerely,

William V. ~~Roth,~~ Jr.
U.S. Senate

Worksheet1

Changes in Budget Estimates

ITEM	2/17/93 Budget FY 1995 Amount	2/94 Budget FY 1995 Amount	Result of 1993 Budget Reconciliation	Change	% Change
Resolution Trust Corporation					
Taxes					
Interest					
Defense					
Social Security					
Medicare					
Medicaid					
Non-Defense Discretionary					
• Agriculture					
• Commerce					
• Education					
• Etc Etc Etc					
Welfare Programs					
Economic Changes					
Re-estimates					

EXECUTIVE OFFICE OF THE PRESIDENT
OFFICE OF MANAGEMENT AND BUDGET
WASHINGTON, D.C. 20503

THE DIRECTOR

April 22, 1994

Honorable William V. Roth, Jr.
United States Senate
Washington, D.C. 20510

Dear Senator Roth:

Thank you for your letter of March 6, 1994, reminding me to expand on some points raised during my testimony before the Senate Finance Committee on February 23, 1994. I enclose responses for the record on two of the three questions you raised, relating to changes in the estimated deficit for fiscal year 1995 and to job gains during recent administrations.

Your third question related to the proportion of the OBRA93 tax increases for 1994 and 1995 that would come from tax returns filed with income from Subchapter S corporations (schedule E), sole proprietorships (schedule C or F), or partnerships (schedule E). (You also asked how many taxpayers fell under this definition of small business and how many of them would face any increase in taxes as a result of OBRA93.) The Office of Tax Analysis of the U.S. Treasury estimates the effects of legislated changes on receipts and the distribution of those changes among specific groups or categories of taxpayers for the Administration, and I have therefore referred your letter to them with a request that they formulate a response to that question and respond to your office directly. I am confident that they will be able to provide a prompt response to your question.

As always, it was a pleasure to appear before Senate Finance and to have the opportunity to talk with you. Thank you for your many courtesies.

Sincerely,

Leon E. Panetta
Director

Enclosures

Enclosure 1

"...summarize the items and amounts that were the result of the 1993 budget reconciliation bill."

See the attached Table 1, from OMB's September 1993 Mid-Session Review of the Budget.

"First, I asked a question regarding the change in your estimates for the FY 1995 budget deficit. That estimate has been reduced by about $120 billion since your February 1993 estimate. I asked for an itemization of the $120 billion figure."

See the attached Table 2, showing components of change in budget deficit.

"Explain an $11 billion increase to $227 billion in non-defense discretionary spending."

See the attached Table 3, showing major changes by agency from 1994 to 1995.

Table 1. DEFICIT REDUCTION PACKAGE

(In billions of dollars)

	1994	1995	1996	1997	1998	1994–1998
Outlays:						
Entitlement changes in reconciliation:						
Increase earned income tax credit	0.1	1.7	4.3	6.0	6.2	18.3
Expand Food stamp assistance	*	0.3	0.5	0.8	1.0	2.7
Extend Big Six formula for determining the Government share of Federal employee health benefits	0.3	0.5	0.6	0.6	0.7	2.8
Promote family preservation/child welfare	0.3	0.1	0.3	0.3	0.3	1.4
Expand social services block grants	0.1	0.4	0.5	*	—	1.0
Increase childhood immunization	—	0.3	0.2	0.2	0.2	0.9
Reform Medicare	–1.9	–5.4	–9.7	–14.0	–18.1	–49.1
Auction radio spectrum	–0.5	–4.3	–4.2	–1.6	–2.0	–12.6
End lump sum and delay COLA's for retired Federal employees	–0.4	–0.3	–2.9	–3.6	–3.7	–11.5
Reform Medicaid	*	–1.0	–1.8	–2.2	–2.3	–7.2
Shift to direct student loans and require States to share default costs	–0.4	–0.4	–0.7	–1.0	–1.1	–3.6
Extend veterans medical cost recovery, increase home loan fees, and revise other veterans benefits	–0.3	–0.6	–0.7	–0.7	–1.2	–3.5
Permanently extend customs fee	—	—	–0.6	–0.6	–0.6	–1.8
Extend Nuclear Regulatory Commission fee	—	—	–0.4	–0.4	–0.4	–1.1
Reform agriculture farm price supports and crop insurance programs	–0.1	–0.4	–0.4	–0.4	–0.4	–1.7
Complete payment of outstanding postal liability	—	—	–0.3	–0.3	–0.3	–1.0
Establish IRS income verification for certain HUD programs	—	—	–0.2	–0.4	–0.4	–1.0
Other	–0.2	–0.7	–1.0	–1.1	–1.2	–4.3
Subtotal, reconciled entitlements	–2.9	–10.3	–16.5	–18.3	–23.3	–71.3
Maintain and extend discretionary caps	–10.2	–17.2	–17.5	–26.6	–36.2	–107.7
Shorten debt maturities	–1.6	–2.7	–3.3	–3.9	–4.9	–16.4
Debt service	–1.3	–5.0	–10.4	–17.3	–25.5	–59.6
Other	–3.2	–0.6	1.5	*	2.6	0.2
TOTAL, outlays	–19.3	–35.8	–46.2	–66.1	–87.3	–254.7
Revenues:						
Extend R&E tax credit	2.1	1.1	0.7	0.3	0.1	4.3
Extend low-income housing tax credit	0.2	0.5	0.8	1.2	1.5	4.3
Increase expensing for small business (Sec 179)	1.6	1.0	0.7	0.4	0.2	4.0
Expand earned income tax credit	*	0.4	0.7	0.9	0.9	2.9
Modify passive loss rules for certain real estate	0.3	0.5	0.5	0.5	0.6	2.4
Modify alternative minimum tax depreciation rules	0.1	0.4	0.6	0.6	0.5	2.1
Establish empowerment zones/enterprise communities	0.2	0.3	0.4	0.5	0.6	2.0
Extend employer-provided education assistance	0.9	0.1	—	—	—	1.0
Provide incentives for small business (capital gains)	*	0.1	0.2	0.2	0.3	0.8
Extend targeted jobs tax credit	0.2	0.2	0.1	0.1	*	0.6
Provide other investment incentives	1.9	0.5	0.2	–0.2	–0.5	1.9
Raise individual income taxes for upper incomes	–17.0	–25.8	–28.5	–26.0	–27.2	–124.5
Repeal HI taxable wage base	–2.7	–6.0	–6.4	–6.8	–7.2	–29.2

Table 1. DEFICIT REDUCTION PACKAGE—Continued
(In billions of dollars)

	1994	1995	1996	1997	1998	1994–1998
Increase transportation fuels tax	–4.5	–4.6	–4.9	–5.0	–5.0	–24.0
Increase taxable portion of social security benefits to 85%	–1.5	–3.9	–4.1	–4.3	–4.5	–18.3
Restrict deduction for business meals and entertainment to 50%	–1.8	–3.1	–3.4	–3.6	–3.9	–15.9
Increase top corporate income tax rate on large corporations to 35%	–3.8	–2.5	–2.6	–2.7	–2.7	–14.3
Extend 2.5 cent-per-gallon motor fuel tax	—	—	–2.6	–2.7	–2.7	–8.0
Modify corporate estimated income tax rules	–1.9	–0.4	–0.1	–3.9	–0.8	–7.1
Modify mark to market for security dealers	–0.9	–1.0	–1.0	–1.0	–0.6	–4.3
Limit possessions tax credit (Sec. 936)	–0.3	–0.7	–0.8	–1.0	–1.1	–3.8
Enforce transfer pricing compliance	–0.2	–0.6	–0.9	–1.0	–1.1	–3.8
Reduce pension compensation cap	–0.3	–0.8	–0.8	–0.9	–0.9	–3.8
Reinstate top estate tax rates at 53% and 55%	–0.5	–0.5	–0.6	–0.6	–0.6	–2.8
Modify deduction for moving expenses	–0.1	–0.5	–0.5	–0.6	–0.6	–2.3
Revise foreign tax credit/oil and gas and shipping income	–0.4	–0.4	–0.4	–0.5	–0.5	–2.2
Extend FUTA surtax	—	—	—	–0.9	–1.2	–2.1
Modify estimated tax requirements for individuals	2.2	0.3	0.3	–4.0	–0.1	–1.5
Other	–1.4	–1.4	–1.9	–2.1	–2.0	–8.7
TOTAL, revenues	–27.4	–46.9	–54.3	–62.5	–58.6	–250.1
Deficit reduction	–46.5	–82.7	–100.6	–128.9	–145.3	–504.8
ADDENDUM:						
Investment increases included above	8.0	8.1	10.6	11.9	12.0	50.5

NOTE: Revenue increase is shown as a negative because it reduces the deficit.
* $50 million or less.

TABLE 2 - CHANGES IN 1995 BUDGET OUTLAY AND RECEIPT ESTIMATES
(In billions of dollars)

	Pre-OBRA Base	Change due to: OBRA 93	Economics	Technical/ Other	Total Change	1995 Budget 1/
Outlays						
Defense discretionary	284.3	NA	NA	-13.3	-13.3	271.1
Nondefense discretionary	274.1	NA	NA	-2.8	-2.8	271.3
Subtotal, discretionary	558.4	-17.2	NA	1.1	-16.1	542.4
Mandatory:						
Deposit insurance	-1.1	-0.2	0.0	-9.8	-10.0	-11.1
Other mandatory	795.5	-13.4	-0.5	-7.6	-21.5	774.0
Subtotal, mandatory	794.4	-13.6	-0.5	-17.4	-31.5	762.9
Net interest	233.3	-5.0	-10.0	-5.2	-20.2	213.1
Total, outlays	1,586.1	-35.8	-10.5	-21.5	-67.8	1,518.3
Receipts	1,284.3	46.9	-1.8	12.8	57.9	1,342.2
Deficit	301.8	-82.7	-12.3	-30.7	-125.7	176.1

1/ Excludes health reform.

TABLE 3 - DOMESTIC DISCRETIONARY: 1994 VS. 1995
(Budget authority in billions of dollars)

	1994	1995	Year-year Change
Domestic Discretionary:			
Agriculture:			
Conservation Programs	1.5	0.8	-0.7
Women, Infants, and Children	3.2	3.6	0.4
Rural housing and utilities	2.5	2.2	-0.3
Other, Agriculture	7.8	7.5	-0.2
Total, Agriculture	15.0	14.2	-0.8
Commerce:			
National Institute of Standards and Technology	0.5	0.9	0.4
Other Commerce	3.1	3.3	0.1
Total, Commerce	3.6	4.2	0.6
Education:			
Goals 2000	0.1	0.7	0.6
Education for the Disadvantaged	6.9	7.6	0.7
Higher education	9.2	9.0	-0.2
Other Education	8.2	8.8	0.6
Total, Education	24.4	26.1	1.7
Energy:			
General science and research	1.6	1.1	-0.5
Other Energy	6.1	6.3	0.2
Total, Energy	7.8	7.4	-0.3
Health and Human Services:			
National Institutes of Health	11.0	11.5	0.5
Head Start	3.3	4.0	0.7
Other Health and Human Services	20.0	19.9	-0.1
Total, Health and Human Services	34.3	35.4	1.1
Housing and Urban Development:			
Homeless programs	0.8	1.3	0.4
Other, HUD	24.3	24.8	0.5
Total, Housing and Urban Development:	25.1	26.1	1.0
Interior	7.5	7.3	-0.2
Justice:			
Crime control fund	0.0	2.4	2.4
Federal prisons and other detention	2.3	2.8	0.5
Other Justice	7.0	6.9	-0.2
Total, Justice	9.3	12.1	2.8
Labor:			
Job training, worker assistance	4.4	5.5	1.1
Other, Labor	6.1	6.2	0.0
Total, Labor	10.6	11.7	1.1
Transportation:			
Federal Highway Administration	-1.7	-0.8	0.9
Federal Transit Administration	1.6	2.1	0.5
Federal Aviation Administration	6.4	7.1	0.7
Other Transportation	4.6	4.9	0.3
Total, Transportation	10.8	13.3	2.5
Veterans Affairs:			
Veterans medical care	15.6	16.1	0.5
Other Veterans affairs	2.0	1.7	-0.3
Total, Veterans Affairs	17.6	17.8	0.2
Environmental Protection Agency	6.7	7.2	0.5
General Services Administration	0.5	1.6	1.1
National Aeronautics and Space Administration	14.5	14.3	-0.2
Small Business Administration	0.7	0.8	0.1
National Science Foundation	3.0	3.1	0.2
Allowances (mostly Procurement/rent reform)	0.0	-1.2	-1.2
Other domestic discretionary	24.9	25.9	1.0
Total, Domestic Discretionary	216.3	227.2	11.0

Enclosure 2

"Modify your chart on job growth to compare the Reagan Administration years to the Clinton Administration years. ...Compare by types of jobs, including, are they part time or full time, what are their comparative wage levels after inflation, what kinds of industries are the jobs coming from?"

During the Reagan Administration (Dec. 1980 - Dec. 1988), private sector employment rose at an average rate of 1,815 thousand jobs a year -- very similar to the figure of 1,843 thousand for the first year of the Clinton Administration (Dec. 1992 - Dec. 1993). During the Bush Administration (Dec. 1988 - Dec. 1992), the average increase had been only 296 thousand a year.

Qualitatively, the major change in the nature of work over the whole period was the decline in employment in goods-producing industries (mining, manufacturing, and construction) -- from 28.4% of total payroll employment in 1980 to 20.9% in 1993 -- and the offsetting rise in service industry employment. The categories of retail trade and finance, insurance and real estate showed slight gains in percentages of total employment between 1980 and 1993, while the wholesale trade and transportation and public utilities categories declined slightly in employment shares. Government employment (not included in private sector employment gains, of course) also fell slightly as a percentage of total payroll employment over the period.

Average hourly earnings in the private sector, adjusted for inflation, fell slightly over the Reagan Administration period (1980-1988), fell slightly more during the Bush Administration period (1988-1992), and held steady over the first year of the Clinton Administration (Dec. 1992 - Dec. 1993).

During the Reagan Administration, the percentage of workers working part time both voluntarily and for economic reasons (such as inability to find full time work) rose only very slightly (from 4.5% to 4.6% and from 13.0% to 13.2%, respectively). During the Bush Administration, the percentage voluntarily working part time declined from 13.2% to 12.6%, while the percentage working part time for economic reasons rose from 4.6% to 5.4%. During the first year of the Clinton Administration, the percentage working part time voluntarily rose from 12.6% to 12.7%, while the percent working part time for economic reasons fell slightly, from 5.4% to 5.2%.

COMMUNICATIONS

STATEMENT OF THE COALITION ON EMPLOYER HEALTH COVERAGE REPORTING AND THE MEDICARE/MEDICAID DATA BANK

Members of the Coalition on Employer Health Coverage Reporting and the Medicare/Medicaid Data Bank submit to the Committee on Finance, U.S. Senate, the following written testimony regarding the implementation and operation of the data bank as proposed by the President's fiscal year 1995 federal budget. Specifically, Coalition members urge the Committee to ensure that the implementation and operation of HCFA's Medicare and Medicaid Data Bank be excluded from the fiscal year 1995 budget until the current employer reporting requirement is replaced with a more efficient and cost-effective source of health coverage information.

The Coalition is a broad-based, ad hoc group of associations, organizations and individual companies reflecting a cross-section of the employer community. The Coalition was formed to work with Congress and the Administration to identify an alternative means to address the secondary payer enforcement and compliance needs of the Health Care Financing Administration (HCFA) that does not impose a disproportionate financial and administrative burden on employers.

BACKGROUND

Beginning with calendar year 1994, an employer that "has, or contributes to, a group health plan, with respect to which at least 1 employee of such employer is an electing individual," must annually report to a new HCFA Medicare and Medicaid Data Bank information relating to the health insurance coverage status of covered employees, their dependents, and other covered electing individuals. An "electing individual" is "an individual associated or formerly associated with the employer in a business relationship who elects coverage under the employer's group health plan."

The reporting requirement was created by §13581 of the Omnibus Budget Reconciliation Act of 1993 (P.L.103–66). This provision adds a new §1144 at the end of Part A of title XI of the Social Security Act (see 42 U.S.C. 1301 et seq.). The information supplied to the data bank is intended to be used to help prevent mistaken payments to physicians and hospitals by Medicare and Medicaid.

The budget the President recently submitted to Congress requested a supplemental amount of $15 million for fiscal year 1994 to implement the data bank, as well as budget authority for the ongoing administration of the data bank in fiscal year 1995 and subsequent years.

ANALYSIS

The Coalition's analysis suggests that, so long as the Medicare and Medicaid Data Bank is based on the current employer reporting requirement, it will neither successfully address HCFA's concerns regarding mistaken primary payments nor justify the financial and administrative burdens imposed on employers.

1. Employer compliance

In many cases it will be impossible for employers to fully comply with current law. Employers cannot easily obtain from employees any missing information that must be reported. For example, employees' responses are frequently unreliable and are time-consuming and expensive to verify. Further, employers' ability to request documentation to verify certain information to be reported, such as dependents' social security numbers, is limited by privacy laws.

Obtaining information about dependents, in particular, will be difficult, time consuming, expensive, and in many cases impossible—especially for employers with high work force turnover. The statute is sufficiently broad that employers appear to be required to report such information about retirees and their spouses, employees' separated/divorced spouses and noncustodial dependent children who are still covered under the employer's health plan, franchisees, participants in Taft-Hartley plans, and many other persons who may fit the definition of "electing individuals" under the statute—all of whom are either geographically dispersed and difficult to locate, or otherwise pose significant administrative problems for employers trying to obtain accurate information.

As a result, employers are at risk to be assessed significant penalties for failure to report information that they do not routinely possess and which they may not be able to obtain from any other source.

2. Administrative and financial burden on employers:

The administrative and financial burden imposed on employers by full compliance with the law is enormous. A significant portion of the information to be reported to the data bank is not currently maintained by employers for any business purpose. Nor is all of the required information routinely maintained by insurers. In many cases, it will have to be compiled manually, at tremendous cost. In the aggregate, employers will have to expend hundreds of millions of dollars *annually* to comply.

The only persons who have all the information HCFA needs are Medicare and Medicaid enrollees themselves. HCFA claims it is too difficult for the government to obtain this information directly from enrollees; instead, HCFA wants to burden employers and their insurers. HCFA is relying on a false premise, however. The information will be far more difficult and expensive for employers to obtain than it is for HCFA to obtain, in part because employers are required to obtain it from tens of millions of additional persons who are neither Medicare nor Medicaid enrollees.

3. Utility of the data collected:

The rationale for the reporting requirement is to allow HCFA to match the health coverage information received against other government records in an effort to identify employer plans that should be paying "primary" and thus prevent mistaken reimbursements for health care services by Medicare and Medicaid. However, employer reporting is an extremely inefficient means to obtain the information HCFA is seeking.

Employers will have to report coverage information for more than 140 million individuals. But only a minute amount of the information employers will report will be relevant to the data bank's purpose because, according to a preliminary General Accounting Office report, only about 2 percent of employees and their dependents are Medicare or Medicaid beneficiaries subject to secondary payer rules. In many industries with a young work force, such as food service and hospitality, the percentage may be even less.

Even where the data reported by employers is relevant, it will still not be sufficient in many cases to enable HCFA to identify or prevent mistaken payments. Moreover, by the time the information is reported to HCFA, processed by the data bank, and incorporated into claims payment systems it will often be a year old or more, further limiting its usefulness.

4. Availability of other sources of data:

HCFA should already receive, when claims are filed, much of the information that is part of the employer reporting requirement. For example, under Medicare the UB-92 and other claims forms require secondary payer information to be reported. In fact, HCFA has not been successful at enforcing this claims-based reporting requirement or fully incorporating the information it does receive into its systems. HCFA has also been unable to take full advantage of additional information it receives from other sources, such as beneficiaries themselves and the Medicare Secondary Payer data match. It makes far more sense to ensure HCFA makes better use of the information that it currently receives than to overwhelm it with data generated by the new employer reporting requirement.

5. Effective date and guidance:

Not only has the federal government imposed an unclear and unworkable reporting requirement on employers, it also has compounded the problem with an unrealistic effective date. Due to several vague provisions in the statutory language, as well as the complete lack of any timely guidance from HCFA, many employers either are unaware that they have an obligation to report this data or cannot determine with any certainty what their obligation is.

It is already too late to provide the guidance employers need to prepare to collect and report data on employees' health coverage status for calendar year 1994. Employers would need to learn about and understand their obligation, train staff, rewrite payroll computer programs, modify health plan open season election forms, and otherwise prepare to report such information before they can successfully comply with the law. Despite employers' good-faith efforts, there is likely to be widespread noncompliance for calendar year 1994 and for an indeterminable period following the eventual publication of guidance.

CONCLUSION

The employer reporting requirement effectively forces employers to perform HCFA's program administration, enforcement and compliance responsibilities in a very inefficient manner. Further, even if the reporting requirement itself were feasible—which it emphatically is not—employers who spend (in the aggregate) hundreds of millions of dollars *annually* attempting to comply with the law in good faith will find their effort and expense squandered since the data received by HCFA will be incomplete, incompatible, or unusable due to the impossibly short effective date and the complete lack of any timely guidance.

Coalition members urge the Committee to ensure that the implementation and operation of HCFA's Medicare and Medicaid Data Bank be excluded from the fiscal year 1995 budget until the current employer reporting requirement is replaced with a more efficient and cost-effective source of health coverage information. We hope to work with you and others in Congress and the Administration to find an alternative means to address HCFA's secondary payer enforcement and compliance needs that does not impose such disproportionate financial and administrative burdens on employers. In particular, we urge that the multiple sources of data and data collection vehicles already available to HCFA be adequately funded and implemented rather than imposing this massive new reporting burden on employers.

O

82-848 (56)