Answers to Questions for the Record
Following a Hearing on the
Budget and Economic Outlook for 2015 to 2025
Conducted by the Senate Committee on the Budget

On January 28, 2015, the Senate Committee on the Budget convened a hearing at which Douglas W. Elmendorf, Director of the Congressional Budget Office, testified about CBO’s report The Budget and Economic Outlook: 2015 to 2025 (January 2015), www.cbo.gov/publication/49892. Following that hearing, Chairman Enzi, Ranking Member Sanders, and other Members of the Committee submitted questions for the record. This document provides CBO’s answers.

Chairman Enzi

Question. The baseline includes drastic increases in the cost of price support programs in the farm bill. The cost projections of the Price Loss Coverage program, for instance, nearly doubled in the ten-year window from last April’s baseline. The Agricultural Act of 2014, passed about a year ago, was based on the May 2013 baseline. When it passed, there were complaints that the price support baseline no longer accurately reflected the agricultural market. Can you explain if the savings that CBO attributed to changes in the price support programs included in the Agricultural Act of 2014 will still materialize?

Answer. The Agricultural Act of 2014 ended direct payments to agriculture producers, who previously had been paid about $4.5 billion annually regardless of the market prices of the crops they produced. Under that act, direct payments were replaced with two new price and revenue support programs known as price loss coverage and agriculture risk coverage. The size of any federal payments under each of those programs depends on crop prices; if those prices fall below the reference prices in the law, then payments to producers are triggered. Estimates of future costs under those programs are much less certain than estimates of future savings from ending direct payments, which did not depend on crop prices. According to CBO’s most recent projections, the replacement of direct payments with the two new programs will probably still yield budgetary savings, but those savings are likely to be smaller than CBO estimated when the legislation was enacted.

CBO’s final cost estimate for the Agricultural Act of 2014, which was made in January 2014, indicated that ending direct payments would save $40.8 billion over the 2014–2023 period. 1

1. Congressional Budget Office, cost estimate for H.R. 2642, the Agricultural Act of 2014 (January 28, 2014), www.cbo.gov/publication/45049. The Agricultural Act of 2014 also eliminated two price and revenue support programs—countercyclical payments and the average crop revenue election program—yielding additional savings, estimated to be $6.2 billion relative to the May 2013 baseline, over the same period. Spending for those programs depended on prices and yields.

Note: Originally transmitted to the Senate Committee on the Budget on February 27, 2015, this document was updated on March 4, 2015, to include answers to questions from Senator Corker, which were inadvertently omitted earlier. Those answers appear at the end of this document.
At that time, CBO estimated that the price loss coverage and the agriculture risk coverage programs would cost $27.2 billion over the 2014–2023 period, or about $13.6 billion less than the cost of continuing direct payments over the same period.2

Those estimates were prepared relative to baseline projections that CBO had issued in May 2013 because CBO and the Budget Committees have a long-standing convention of using a consistent baseline to prepare cost estimates for major legislation when its consideration spans the first and second sessions of a Congress. Therefore, the final cost estimate for the Agricultural Act of 2014 reflected crop price forecasts that had been developed early in 2013. However, by the time the Agricultural Act of 2014 became law on February 7, 2014, the historically high crop prices had begun to fall.

CBO now expects that crop prices in general will be significantly lower over the next 10 years than it anticipated in May 2013. For its January 2015 baseline, CBO estimated that the price of corn will average $3.97 per bushel over the 2016–2023 period, 14 percent less than the $4.63 per-bushel average anticipated for the same period in the May 2013 baseline.

On the basis of that January 2015 forecast, the budgetary savings from replacing direct payments with the price loss coverage and agriculture risk coverage programs are now expected to be less than CBO estimated when the Agricultural Act of 2014 was enacted. CBO now projects that the price loss coverage and agriculture risk coverage programs will cost $36.7 billion over the 2014–2023 period, about $9.5 billion more than it estimated when the law was enacted.3

Crop prices could turn out to be higher or lower than CBO currently anticipates. Hence, the actual budgetary savings realized or costs incurred from ending direct payments and replacing them with price loss coverage and agriculture risk coverage could be greater or smaller than the amounts CBO estimated when the Agricultural Act of 2014 was enacted. For each annual baseline, CBO develops a consistent set of projections for the supply, use, and prices of major crops over the next 10 years.4 The agency aims for its forecast of prices to be in the middle of the distribution of potential outcomes; consequently, the current forecast is as likely to be too high as it is to be too low.

Such estimates are very uncertain because crop prices have historically been highly variable, as shown in the figure below. The average year-to-year change in the price of corn, in one direction or the other, was $0.50 per bushel over the 1975–2013 period. The largest annual change during that period was $2.43 per bushel. Those changes represented a significant percentage of the average price of corn during that period, which was $2.82 per bushel.

In the past decade, corn prices rose sharply under tighter market conditions—in important part because of high oil prices and the enactment of renewable fuel standards (and the consequent increased demand for corn-based ethanol). Over the past year, corn prices fell as those market conditions began to reverse. In addition, weather and other influences on commodity markets often lead to significant changes in supply and demand for commodities even within a single year, not just from one year to the next.

2. CBO’s baseline projections incorporated the assumption that direct payments would continue indefinitely, although they were scheduled to expire with the 2013 crop, following the rules for developing baseline projections specified by the Balanced Budget and Emergency Deficit Control Act of 1985.

3. That estimate reflects the assumption that those programs will be in effect throughout that period.

4. For the most recent projections, see Congressional Budget Office, USDA Mandatory Farm Programs—Baseline Projections (January 2015), www.cbo.gov/publication/44202.
**Question.** The Highway Trust Fund is currently insolvent. Since 2005, spending has far exceeded revenues because gas-tax levels plateaued while spending grew. To make up for funding shortfalls, the trust fund has required large general fund contributions totaling more than $50 billion since 2008. Although a bill with questionable offsets extends highway funding until May 2015, there is still no long term solution. CBO projects that the Highway Account of the Highway Trust Fund will have difficulty meeting obligations sometime during the latter half of Fiscal Year 2016. The HTF will still require more than $170 billion in bailouts, with the next installment necessary at some point in FY 2015. Revenues are far less than outlays. Is that correct? Are there any options besides raising the gasoline tax or reducing spending that will provide long-term solvency for the HTF? Would moving Transit spending to the General Fund provide any long-term relief for the HTF? Should we eliminate the Highway Trust Fund altogether and fund all highway improvement programs with discretionary funds? What if we had a separate budgetary cap for Highway Trust Fund spending? Should we increase the gas tax to a level that will ensure the solvency of the Highway Trust Fund indefinitely? What would that option look like?

**Answer.** In the past 10 years, outlays from the Highway Trust Fund have exceeded the fund’s income (apart from transfers from other funds) by more than $65 billion. Since 2008, lawmakers have addressed shortfalls by transferring $65 billion, mostly from the general fund of the Treasury, to the Highway Trust Fund. If current policies are maintained, the fund’s revenues will continue to fall short of the amounts necessary to cover spending for the programs it finances. Specifically, if obligations from the fund continued at the 2015 rate (with increases to account for future inflation) and the expiring taxes on fuels and heavy vehicles were extended at their current rates, the gap between the projected spending and the projected tax revenues would amount to $164 billion over the 2015–2025 period. Under current law, the trust fund cannot incur negative balances, nor can it borrow to cover unmet obligations.5

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To help balance the trust fund’s resources and outlays, lawmakers could choose to reduce spending for surface transportation programs, boost the fund’s revenues, authorize additional transfers, or adopt some combination of those approaches:

- If lawmakers chose to address the projected shortfalls solely by cutting spending, over the 2016–2025 period, the highway account would see a decrease of more than 30 percent in the authority to obligate funds, and the mass transit account’s authority would decrease by about 60 percent, compared with CBO’s baseline projections.

- Revenues credited to the trust fund could be increased by raising existing taxes on motor fuels or other transportation-related products and activities or by imposing new taxes on highway users, such as those based on vehicle-miles traveled. The staff of the Joint Committee on Taxation (JCT) estimates that a 1 cent increase in taxes on motor fuels—primarily gasoline and diesel fuel—would raise about $1.5 billion each year for the trust fund. If lawmakers chose to meet obligations projected for the trust fund solely by raising revenues, they would need to increase motor fuel taxes by between 10 cents and 15 cents per gallon, starting in fiscal year 2016. The trust fund’s revenues could also be boosted by raising new revenues from nontransportation sources and allocating them to the fund.

- The trust fund could also continue to receive supplements from the general fund—which could be accomplished either by transferring specific amounts of funds or by designating that funds from a particular source be credited to the Highway Trust Fund. To finance projected spending without increasing taxes or generating new revenues for the trust fund from other sources, lawmakers would need to transfer $5 billion in 2015 and between $12 billion and $18 billion every year thereafter through 2025. Spending resulting from such general fund transfers could be paid for by reducing other spending, by increasing broad-based taxes, or by increasing federal borrowing.

Moving new spending for transit from the Highway Trust Fund to the general fund and transferring revenues currently credited to the transit account to the highway account would leave substantial shortfalls in the Highway Trust Fund in both the short term and the long term. As under current law, such shortfalls would prevent the program from operating normally in any year, starting in 2015. Over the 2015–2025 period, CBO projects that shortfalls in the highway account will amount to $125 billion. CBO further projects that the transit account will be credited with revenues of about $5 billion per year over the 2015–2025 period (totaling about $53 billion), leaving a shortfall of $72 billion in the highway account even if all of the transit account’s revenues were credited to the highway account. Moreover, crediting those future deposits to the highway account would prevent the transit account from meeting obligations that have already been made. That is because most obligations from the transit account (and from the highway account as well) involve capital projects that take several years to complete, and most of the transit account’s current obligations will therefore be met using tax revenues that have not yet been collected. At the end of 2014, for example, $16 billion in contract authority for transit programs had been obligated but not spent and another $8 billion was available to states but not yet obligated. As a result, even if states were given no further authority to commit

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6. For more information about the range of options available to the Congress for deciding how much to spend on highways and other surface transportation programs and for deciding how to finance that spending, see the testimony of Joseph Kile, Assistant Director for Microeconomic Studies, Congressional Budget Office, before the Senate Committee on Finance, The Status of the Highway Trust Fund and Options for Financing Highway Spending (May 6, 2014), www.cbo.gov/publication/45315.

funds from the transit account, another five years’ worth of motor fuel taxes would need to be credited to the transit account just to meet the account’s obligations at the end of 2014. Thus, taxes on motor fuels now credited to the transit account could not be used by the highway account for the next five years.

One possible change, which you inquired about, is to eliminate the Highway Trust Fund and treat surface transportation programs as entirely discretionary, possibly with a separate budgetary cap. Currently, the programs’ budget authority is mandatory, and their annual obligations are controlled by limits set in appropriation acts. As a result, surface transportation programs funded from the Highway Trust Fund are generally not subject to the processes that control spending for most other programs, including sequestration for mandatory programs, statutory pay-as-you-go rules, and caps on discretionary funding. Under the possible change, surface transportation programs would be subject to trade-offs similar to those that affect all other discretionary priorities. If funding was not constrained by trust fund revenues, lawmakers would have more flexibility in setting spending amounts, but because funding would be provided one year at a time, this option could reduce the ability of states to plan for future capital expenditures, as they would not have multiyear transportation acts. Such a change would also significantly alter the way the Department of Transportation (DOT) carries out its programs. Under current law, future contract authority is one of the factors that grantees take into account when developing the multiyear transportation plans that must be approved by DOT before funds can be obligated. Another consideration is that general funds are often a less efficient source of financial support for infrastructure than are user fees because they provide no incentive for the efficient use of the infrastructure.

CBO has not analyzed the possible effects of creating a separate budgetary cap for highway and transit spending. Such a cap existed under previous authorizations for transportation programs, the Transportation Equity Act for the 21st Century and the Safe, Accountable, Flexible, Efficient Transportation Equity Act: A Legacy for Users.

Another approach for dealing with the projected shortfalls in the Highway Trust Fund would be to place more of the responsibility for highway infrastructure on state and local governments, perhaps by facilitating greater use of borrowing by those governments to finance highway projects. State and local governments (and some private entities) can currently use tax-preferred bonds that convey subsidies from the federal government in the form of tax exemptions, credits, or payments in lieu of credits to finance road construction.

**Question.** In the February 2014 baseline, CBO conducted its first comprehensive analysis of the labor market effects of the health care law. The analysis found that by 2024, the equivalent of 2.5 million Americans will exit the labor force or work less as a result of the law. CBO also estimates the law will reduce the total number of hours worked by 1.5 to 2 percent during the FY 2017-2024 period and will cause a 1 percent reduction in aggregate labor compensation over the same period. As you previously clarified in response to a question for the record from Budget Committee Member last year: “… reductions in the amount of labor income earned in the economy will lead to reduced income and payroll tax revenues. CBO’s baseline economic and revenue projections incorporate the agency’s estimates of the effects of federal policy on economic activity and tax revenues. Hence, those projections account for the ACA, including its effects on labor markets. However, CBO has not attempted to isolate the revenue effect of the labor market changes attributable to the act from other factors that affect economic activity or tax revenues overall.” Since the time of your response, has CBO ever attempted to estimate the size of the revenue loss associated with the labor market effects of the health care law? If so, approximately how large is that effect? And would including that
lower revenue estimate in the cost of the law (through the use of dynamic modeling), as you are now required to do by the House scoring rule, change your overall assessment of the 10-year net deficit impact of Obamacare?

**Answer.** On the basis of its analyses of the ways in which changes in the supply of labor generally affect the overall economy and therefore the federal budget, CBO expects that the reductions in the supply of labor resulting from the Affordable Care Act (ACA) will reduce federal revenues. However, CBO has not attempted to estimate the impact of the overall economic effects of the ACA on the federal budget. If macroeconomic effects had been included in the cost estimate for the ACA that CBO provided in March 2010, the estimated net effect of that legislation on the deficit would probably have been less favorable than that which was shown.

**Question.** CBO projects that the Social Security Disability Insurance trust fund will run out of money by 2017. This will require Congress to act in advance of the insolvency date. In the past, CBO has written that changes in demographics cannot explain the rise in DI enrollment over the last 30 years. Is that still your assessment? If so, why?

**Answer.** Over the past 30 years, the number of disabled workers who receive benefits from the Social Security Disability Insurance (DI) program has increased more than threefold, rising from 2.7 million in 1985 to 9.0 million in 2014. Multiple factors help explain the DI program’s rapid growth, and CBO has grouped them into three categories: changes in demographics and an increase in the number of workers; changes in federal policy; and changes in opportunities for employment and in compensation.\(^8\)

The increase in DI enrollment between 1985 and today can be attributed, in part, to changes in demographics and an increase in the number of workers. The aging of the large baby-boom generation (people born between 1946 and 1964), and consequently the aging of the workforce, has led to an increase in the share of workers who enter the DI program. Older workers are far more likely than younger workers to qualify for DI benefits for the following reasons: More older people suffer from debilitating conditions, and the program’s qualification standards for older workers are less strict than those for younger workers because older people are assumed to be less able to adapt to new types of work. In addition, the increase in the number of people who are eligible to receive benefits if they become disabled—largely stemming from an increase in the number of women participating in the labor force—has been a factor in the growth in DI enrollment.

Changes in federal policy have also contributed to growth in the DI program over the past 30 years. For example, enactment of the Social Security Disability Benefits Reform Act of 1984 expanded the ways in which people could qualify for the DI program—such as allowing applicants to qualify for benefits on the basis of multiple medical conditions that, taken alone, might not have met the qualifications for participation in the program and allowing symptoms of mental illness and pain to be considered in assessing whether a person qualifies for the DI program. Those changes in policy led to a substantial expansion in the share of DI beneficiaries with mental or musculoskeletal disorders, many of whom enter the program at younger ages than do people with other types of disabilities. In addition, the incremental

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rise in the full retirement age for Social Security that occurred during the past decade has increased enrollment in the DI program in two ways: It has enlarged the potential pool of DI applicants by increasing the age of eligibility for unreduced Social Security retirement benefits; and it has increased the length of time people can receive DI benefits, as DI beneficiaries now shift to the Social Security retirement program later than in previous years.

Finally, changes in opportunities for employment and in compensation have been a factor in the growth in the DI program over the past three decades. For example, short-term economic downturns can have long-run effects on DI enrollment. Many people who have been out of work for long periods find it hard to reenter the labor force and may turn to the DI program for support. Once they start receiving DI benefits, only a very small share will permanently leave the program to return to the workforce. In addition, because the earnings of low-wage workers have increased more slowly than average earnings per worker in the economy and the DI program uses average earnings growth to determine changes in benefits, those benefits have risen to be a greater share of the earnings of low-wage workers. That increase in benefits relative to the compensation associated with working has probably increased the number of people seeking DI benefits over the past 30 years. Furthermore, access to health insurance and the cost of obtaining it are factors that may have affected DI enrollment. Disabled beneficiaries receive coverage under Medicare, regardless of their age, generally after a 24-month waiting period. For workers without employment-based health insurance, that eligibility for Medicare may have encouraged them to apply for DI benefits.

**Question.** On Monday, January 26, 2015, *Congressional Quarterly* ran an article with the inaccurate headline “CBO Cuts Estimate of Health Law Cost by $101 Billion.” Unfortunately, many other news outlets also inaccurately reported that the total cost of Obamacare had come down by that amount. But CBO’s report states on p. 115 that “Those estimates address only the insurance coverage provisions of the ACA and do not reflect all of the act’s budgetary effects.” Isn’t it true that most of the lower net cost of the health care law comes from higher revenues as fewer people are able to keep their employer-sponsored insurance?

Looking at Table B-4 on p. 126, this $101 billion change is a reduction in the net cost of only a subset of the law (i.e. the coverage provisions). However, is it the case that CBO also concluded that the gross cost of these provisions changed very little since your previous baseline?

CBO’s tables also show that the primary factor behind the estimated reduction in the net cost of these coverage provisions is that, on net, an additional 2 million people who liked their employer sponsored insurance are now estimated to lose it under your baseline projections—and will thus have to pay higher taxes on their wages or their health insurance as a result. So isn’t it an appropriate takeaway from this change that if you like your health care plan, you can’t necessarily keep it?

**Answer.** In a comparison of CBO and JCT’s current and previous estimates of the effects of the insurance coverage provisions of the Affordable Care Act, CBO reported a reduction of $101 billion in the estimated net cost of those provisions over the 2015–2024 period. The following differences between the baseline projections released in January 2015 and those provided in April 2014 account for that change:
A reduction of $9 billion in the estimated gross cost of the coverage provisions, resulting from:

- A reduction of $68 billion attributable to lower exchange subsidies and related spending and revenues;
- An increase of $59 billion caused by higher outlays for Medicaid and the Children’s Health Insurance Program (CHIP); and
- A slight reduction in tax credits for small employers.

An increase of $5 billion in projected net costs stemming from changes in estimated penalty payments and estimated collections from the excise tax on high-premium insurance plans; and

A reduction in estimated net costs of $97 billion from other effects on revenues and outlays, which consist mainly of the effects of changes in taxable compensation on revenues.

The $9 billion reduction in the estimated gross cost is small (about 0.5 percent) relative to CBO’s previous projection of $1,839 billion for the gross cost over the 2015–2024 period. The largest change in the estimates—$97 billion related primarily to an increase in estimated taxable compensation—stems from a combination of improvements in estimating methodology and a downward revision to the number of people who are projected to have employment-based coverage in most years. Less employment-based coverage (about a million fewer people in most years of the projection period) means that taxable compensation in the form of wages and salaries will be greater, or that corporate profits will be greater, leading to higher federal revenues. That change in estimated taxable compensation is also small relative to the total amount of compensation that is provided in the form of employment-based health insurance and excluded from taxable income.

CBO currently projects that the ACA will reduce the number of people with employment-based coverage in 2024 by 9 million on net, compared with what the number would have been if the law had not been enacted. (The difference from 7 million reported in April 2014 is equal to about 1 million rather than 2 million because of rounding.) That net reduction consists of various flows both in and out of employment-based coverage stemming from the ACA. In 2024, 14 million people are projected to not receive an offer of employment-based coverage that they would otherwise have received and 3 million people are projected to decline an existing offer of employment-based coverage. Some of those 17 million people are expected to gain coverage from another source, whereas others will forgo health insurance altogether. That number is partially offset by the 8 million people who are projected to gain employment-based coverage that they would not have had in the absence of the ACA. CBO cannot assess how many of the people affected would have preferred the coverage they would have obtained if the ACA had not been enacted.

### Ranking Member Sanders

**Question.** CBO’s methodology for developing the baseline it uses for its projections are set by law. Last year, this committee examined some of the impacts that climate change would have on the economy and on the federal budget, and we heard testimony from experts at GAO, national security experts, and others who said that there will be growing impacts on federal
spending and the economy that will ultimately drive increases in the debt. Does CBO’s baseline incorporate these increasingly significant costs of climate change? How would the fiscal impacts of climate change be affected if, globally, we were able to reduce emissions and make communities more resilient to the effects of climate change.

**Answer.** CBO’s baseline projections for the next 10 years generally reflect current law. Some of the programs most affected by weather-related disasters—such as federal crop insurance and flood insurance—are mandatory spending programs. For those programs, CBO attempts to incorporate into its projections all factors that might affect spending under current law, including changes in the way land is used and trends in crop yields, which may be affected by climate change. Reductions in greenhouse gas emissions over the next decade would probably have a very small impact on those programs because the effects of those reductions would primarily be realized beyond the 10-year projection period, CBO anticipates.

Other programs affected by weather-related disasters, such as the Federal Emergency Management Agency’s disaster relief program, are discretionary. In CBO’s 10-year baseline projections, as specified in law, the amount appropriated for the current year is assumed to be provided in each subsequent year, with an adjustment for inflation. Thus, the baseline incorporates an assumption that funding for disaster relief in each year of the coming decade will be similar to that provided in the current year.

The Congress has typically responded to large-scale disasters, such as Hurricanes Katrina and Sandy, by changing the law to increase spending—providing emergency supplemental appropriations for disaster relief, for example. (Total appropriations for disaster relief amounted to $135 billion over the 2005–2014 period, much of which was provided in 2005 and 2006 in response to Hurricanes Katrina, Rita, and Wilma.) Under the rules that govern baseline projections, CBO does not attempt to predict the frequency or magnitude of such events or the Congress’s response to them.

In the future, lawmakers might increase funding relative to baseline projections if the effect of climate change on the frequency and magnitude of weather-related disasters became larger. For example, increased damage from storm surges might lead the Congress to pass additional emergency supplemental appropriations for disaster relief or to approve legislation that would provide funding to protect infrastructure that is vulnerable to rising sea levels. The Congress might also amend existing laws so as to limit federal spending on weather-related disasters. For example, lawmakers might alter the flood insurance or crop insurance programs in a way that would provide insured parties with greater incentive to avoid potential damage. But CBO’s baseline projections, which are built on current law, cannot capture such possible changes.

Climate change may also affect the nation’s economic output and, consequently, federal tax revenues. However, estimates by researchers suggest that those effects will probably be very small over the next 10 years. For example, one recent study found that the effect of climate change on the productivity of outdoor workers over the 2020–2039 period would probably lie between an increase of 0.03 percent and a decline of 0.38 percent, on the basis of a global emissions scenario that is consistent with a modest shift away from fossil fuels or a slowdown in economic growth.9 Such estimates are very uncertain, however.

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**Question.** In its most recent (2014) report on the state of the global economy, the IMF—a longtime advocate for fiscal austerity—came out in favor of substantially increased public infrastructure investment, saying that increased spending on infrastructure could reduce rather than increase government debt burdens over time. Do you agree?

**Answer.** The effects on government debt of increased federal spending on infrastructure—such as highways, mass transit, aviation, rail and water transportation, water resources, and water utilities, which together account for the bulk of federal spending for infrastructure—would depend on the particular spending policy. In general, increases in such spending have an impact on the economy in both the short and the long run:

- In the short run, as is the case for other government purchases, an increase in federal infrastructure spending boosts output by increasing total demand for goods and services. That boost tends to be larger when output is well below its maximum sustainable amount and the Federal Reserve’s response to changes in fiscal policies is likely to be limited.

- In the long run, increases in federal infrastructure spending—if not offset by decreases in other spending or increases in taxes—have opposing effects on economic output. The increase in spending raises government borrowing, which tends to “crowd out” private investment, lowering output. However, increased federal spending on infrastructure also generally raises productivity in various ways, which tends to boost output.

The economic effects would “feed back” to the budget and affect the size of deficits and debt. CBO estimates the budgetary implications of the economic effects generated by changes in fiscal policy using a simplified analysis that takes into account changes in taxable income and interest rates, among other things, but does not incorporate a detailed program-by-program analysis, as do CBO’s regular budget estimates.

On the basis of CBO’s past analyses of changes in federal spending programs, the agency expects that most of the estimated effects on the budget of increased federal spending on infrastructure would probably stem from two factors: changes in output, which would affect revenues by altering the amount of taxable income; and changes in interest rates (resulting from the changes in deficits and debt), which would affect the federal government’s interest payments. CBO’s estimates also generally account for the influence of other factors on the budget, such as the impact of changes in prices on federal spending for purchases and transfer payments and the effect of changes in the unemployment rate on federal spending for unemployment benefits. However, CBO has not undertaken an analysis of the net effect on the budget of a specific infrastructure policy.

**Question.** CBO’s estimate of the cost of the Affordable Care Act is 20 percent lower than it was when you issued your first official estimate and 7 percent lower than what you projected in your April 2014 estimate. That was just eight months ago. Clearly, such projections are already very uncertain. Wouldn’t undertaking dynamic scoring add yet another layer of uncertainty?

**Answer.** Many of CBO’s projections are very uncertain, so the agency aims for those projections to be in the middle of the distribution of possible outcomes given the baseline assumptions about federal tax and spending policies, while recognizing that there will always be deviations from any such projections. Following a long-standing convention, CBO’s cost estimates for individual legislative proposals have not included macroeconomic effects—
except for estimates provided for comprehensive immigration legislation, which would significantly increase the U.S. labor force. (Assuming that such legislation would have no effect on overall output would distort the estimates too severely.) Including macroeconomic effects in cost estimates would add another source of potential variability to those estimates.

**Question.** CBO’s Budget and Economic Outlook provides a long-range forecast for the budget deficit as a percentage of GDP, but it doesn’t include a forecast for the trade deficit as a share of GDP in each of the same years. Can that be included in future such reports?

**Answer.** CBO’s budget projections for the next 10 years are based on a detailed economic forecast. The agency’s projection of net exports as a percentage of gross domestic product (GDP) is provided below. CBO can provide this information to the Congress in the future.

**CBO’s Projection of Net Exports as a Percentage of GDP, 2015 to 2025**

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<th>Year</th>
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Source: Congressional Budget Office.
Note: GDP = gross domestic product.

**Question.** At the end of last year, Congress attached H.R. 992 to the omnibus spending bill. This provision allowed systemically important financial institutions to place derivatives trades into their federally-insured subsidiaries, as opposed to having to place these bets in non-insured subsidiaries without access to taxpayer dollars. In other words, it gave large banks an implicit government backing of roughly $7 trillion of notionally valued derivatives. More importantly, as FDIC Vice Chairman Tom Hoenig pointed out, these are the riskiest derivatives, including uncleared credit default swaps and equity derivatives. When CBO did its cost estimates of this legal change, it made the following estimate: “CBO estimates that any impact on the net cash flows of the Federal Reserve or the FDIC over the next ten years would not be significant.” Is CBO implying that allowing Wall Street banks to place derivatives bets with taxpayer backing does not risk increasing the deficit? How did you come up with this estimate?

**Answer.** Enactment of H.R. 992, the Swaps Regulatory Improvement Act, modified the Dodd–Frank Wall Street Reform and Consumer Protection Act to allow insured depository institutions to retain some financial instruments known as swaps while remaining eligible for assistance from the Federal Deposit Insurance Corporation (FDIC) and the Federal Reserve.10

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A swap is a contract between two parties to exchange payments on the basis of the price of an underlying asset or a change in interest, exchange, or other reference rate. Swaps can be used to hedge—or mitigate—certain risks associated with a firm's traditional activities, such as interest rate risk, or to speculate on the basis of expected changes in prices or rates.

In its cost estimate for H.R. 992, CBO concluded that enactment of the legislation would not significantly alter federal spending attributable to bank failures and assistance over the next 10 years. In reaching that conclusion, the agency considered the amount of swap activity, the potential losses, banks' capacity to absorb losses, and the extent to which the federal government might ultimately bear any losses, as follows:

- Most swaps will not be affected by H.R. 992. The provision of Dodd–Frank that prohibited insured depository institutions from retaining swaps did not apply to swaps held for hedging purposes or to swaps involving certain permissible securities. (Such swaps include those that reference interest rates, exchange rates, government securities, and precious metals.) Swaps referencing interest and exchange rates currently make up over 90 percent of all such instruments held by insured commercial banks and savings institutions and will not be affected by H.R. 992.

- Potential losses to banks from their retention of swaps are much smaller than the total notional value of such swaps. The notional value of swaps that will remain with insured depository institutions as a result of the bill is projected to be very large, despite the fact that most swaps will not be affected. Potential losses are much smaller in part because maximum payments on any one contract are generally a small percentage of the notional amount and because multiple offsetting contracts between counterparties—that is, between the entities that have entered into contracts—are common. Swap transactions pose the risk of large losses to banks through two main channels: risks from potential default on obligations of counterparties to the swap transactions and risks that result from either speculation or imperfect hedging. Based on information from the Office of the Comptroller of the Currency (OCC), CBO estimates that potential losses to depository institutions from the failure of counterparties to make payments related to swaps that will be affected by the bill amount to about 0.4 percent of the notional amounts—about $30 billion. (This amount represents a projection of the maximum loss that would be incurred by all banks if all of their counterparties were to fail to make payments over the projected life of their current contracts.) The potential exposure from speculation or imperfectly executed hedging transactions could be larger. For example, a single institution, JP Morgan Chase, suffered more than $6 billion in losses from the activities of the trader known as the London Whale. However, other bank regulations are designed to limit such risks.

- The depository institutions that will be most affected are extremely large and, in most cases, will be able to absorb sizable credit losses on swaps without significantly increasing the risk of failure. The vast majority of swap activity occurs in a few institutions. According to OCC, four banks—Citibank, JP Morgan Chase, Goldman Sachs, and Bank of America—account for over 90 percent of the notional value of swaps housed in commercial banks and thrifts. The largest 25 institutions account for nearly 100 percent. The exposures of those institutions to potential losses on swaps are generally considerably smaller than the institutions' capital. For example, the $6 billion loss suffered by JP Morgan Chase was much smaller than the bank's capital (specifically, its common equity tier 1 capital) of $165 billion and net income of $22 billion in 2014.
Any federal spending to assist financial institutions that suffer losses on swaps stemming from enactment of H.R. 992 will probably be offset by payments from the banking industry. If a large insured institution involved in swap activity were to fail, it would be closed following the FDIC’s resolution procedures. Additionally, if a systemically important holding company of an insured institution were to fail, it could be resolved under FDIC’s Orderly Liquidation Authority established under the Dodd–Frank Act. Under current law, any federal spending resulting from the use of FDIC’s authorities, net of recoveries, will be recouped through assessments on the industry, resulting in no significant net effect on the budget over time. Thus, although the swap dealers will probably benefit from increased swap activity under the legislation, any federal costs stemming from that increased activity will probably be recovered from insured banks and their customers.

**Question.** The federal government has many loan and loan guarantee programs—student loans, housing loans, and rural electric loans—on which Americans rely. Has CBO done analysis on how much switching to Fair Value accounting would increase costs to users of loan and loan guarantee programs? If so, could you share this analysis with the committee?

**Answer.** The accounting method that CBO uses to provide its official estimates of the costs of federal credit programs is prescribed by the Federal Credit Reform Act of 1990 (FCRA). That legislation requires such costs to be measured by discounting expected future cash flows associated with a loan or loan guarantee to a present value at the time of disbursement. The discount rate used for FCRA estimates is tied to Treasury securities rather than to market rates. Thus, although the FCRA methodology accounts for expected losses from defaults, it does not account for the fact that losses from defaults tend to be highest when economic and financial conditions are poor, which is when resources are scarcer and hence more valuable.

Fair-value accounting differs in that it recognizes such market risk—the component of financial risk that remains even after investors have diversified their portfolios as much as possible and that arises from shifts in current and expected macroeconomic conditions—as a cost to the government. To incorporate the cost of such risk, present values in fair-value accounting are calculated using market-based discount rates. Thus, fair-value estimates generally imply larger costs to the government for issuing or guaranteeing a loan than do FCRA-based estimates.\(^\text{11}\)

Last year, CBO found that if fair-value procedures had been used to estimate the cost of credit programs in 2014, the total deficit would have been about $50 billion greater than the deficit as measured using current estimating procedures.\(^\text{12}\) Much of the difference derived from the valuation of student loans: Under FCRA procedures, those loans generate very large budgetary savings per dollar lent compared with other federal credit assistance; under the fair-value approach, most of those savings disappear.

Switching from a FCRA approach to a fair-value approach to recording costs in the federal budget without making any changes to credit programs themselves would not affect costs for

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users of loan and loan guarantee programs. However, the use of fair-value accounting could affect Congressional decisions about the volume of loans to be made or guaranteed, the fees charged to borrowers, or other terms associated with any new loans or loan guarantees—perhaps to reduce estimated budgetary costs. Without an adjustment to the caps on discretionary funding, appropriations for other programs might have to be reduced to make up for the higher budgetary costs of credit programs. Further, if a FCRA approach was replaced by a fair-value approach for a purpose other than recording costs in the federal budget—such as part of a requirement that fees on loans to small businesses be set so that those loans would have no cost on a fair-value basis—then costs for users of some programs would be increased.

**Question.** In your 2012 report, CBO analyzed 103 loan and loan guarantee programs, of which almost three-quarters were discretionary programs. The report stated that, overall, discretionary programs scored under the Federal Credit Reform Act have a subsidy rate of -2 percent. However, under Fair Value accounting, many discretionary programs would have a positive subsidy rate, or a cost. How much would a change to Fair Value accounting impact the defense and non-defense discretionary Budget Control Act caps? Wouldn't a change in accounting rules trigger a sequestration?

**Answer.** Last year, CBO analyzed the potential effects of legislation that would have amended the Federal Credit Reform Act of 1990 to require that, beginning in fiscal year 2017, the cost of loans or loan guarantees be estimated on a fair-value basis, using guidelines set forth by the Financial Accounting Standards Board, and recognized in the budget accordingly. A fair-value approach to accounting for the cost of federal loans and loan guarantees would produce estimates of costs that either correspond to or approximate the value of those loans or guarantees to buyers in the private market.

CBO found that if fair-value procedures had been used to estimate the cost of credit programs in 2014, the total deficit would have been about $50 billion greater than the deficit as measured using current estimating procedures. That increase would have been split between the mandatory and discretionary portions of the budget:

- On a FCRA basis, CBO estimated, net subsidies for mandatory credit programs would have reduced the federal deficit by about $20 billion in 2014. On a fair-value basis, those programs would have increased the deficit by about $10 billion, for a swing of roughly $30 billion.

- Using a FCRA approach, net receipts from discretionary credit programs reduced the estimated cost of appropriations in 2014 by about $10 billion. Using a fair-value approach, CBO estimates, those same programs would have required appropriations of about $10 billion, for a swing of roughly $20 billion.

If fair-value procedures were implemented, the budget would record increased budget authority and outlays for mandatory programs; fully funding them on a fair-value basis would require no further Congressional action. However, the estimated net cost of legislative proposals for establishing new mandatory credit programs or expanding existing programs (such as student loans) would generally be larger using fair-value procedures than they would be on a FCRA basis.

13. Ibid.
To account for the higher subsidy costs that would result if future appropriations for federal credit programs were measured on a fair-value basis, H.R. 1872 would have clarified that the caps on discretionary appropriations set forth in the Budget Control Act of 2011, as amended, would be adjusted upward. The Deficit Control Act provides the Office of Management and Budget with authority to adjust caps on discretionary funding to account for “changes in concepts and definitions.”14 Without such an adjustment, appropriations would have to be reduced to make up the $30 billion difference, or sequestration would be triggered. CBO cannot predict whether the Office of Management and Budget would choose to make an adjustment to the discretionary caps (using the authority in the Deficit Control Act) for a change to fair-value accounting. Discretionary credit programs are all categorized as nondefense in the budget, so only nondefense discretionary funding would be affected.

**Senator Baldwin**

**Question.** I am concerned about the impact on federal spending and on access to coverage in states, like my home state of Wisconsin, that have not expanded their Medicaid programs under the Affordable Care Act (ACA). Instead of expanding our BadgerCare program, our Wisconsin Governor kicked thousands of individuals off Medicaid with a promise to transition them to coverage in the ACA’s Marketplace. While a number of these individuals obtained coverage, not all of these vulnerable Wisconsinites were able to enroll in the Marketplace and may remain uninsured. Can you please describe the federal budgetary effects as a result of states like Wisconsin that do not expand Medicaid coverage under the ACA?

**Answer.** States that choose not to expand Medicaid coverage under the ACA will have more uninsured people and fewer beneficiaries in Medicaid and the Children’s Health Insurance Program—lowering federal costs—and more people receiving subsidies for health insurance through exchanges—raising federal costs—than they would if they had expanded Medicaid coverage. In 2012, CBO projected that, because of the decision by some states not to expand Medicaid coverage under the ACA, the net cost to the federal government of the insurance provisions of the ACA would be reduced by $84 billion over the 2012–2022 period: Federal spending for Medicaid and CHIP would be $289 billion less because of those choices, whereas the estimated costs of tax credits and other subsidies for the purchase of health insurance through the exchanges (and related spending) would be $210 billion more.15 Another $5 billion in savings would stem from changes in other components of the budget estimates.

Those estimates from 2012 reflected CBO’s projections at that time of the approximate shares of the affected population residing in states that would fall into different broad categories—ranging from no expansion to an expansion encompassing the income threshold established by the ACA. CBO has not undertaken a more recent analysis comparing the effects of states’ choices with what would have occurred if all states had expanded Medicaid coverage.

**Question.** After the Supreme Court decision in 2012, CBO released updated estimates of the budgetary effects of the health insurance coverage provisions of the ACA, which projected that the average annual cost per Medicaid enrollee in 2022 will be $6,000, while the

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analogous cost per exchange enrollee will be $9,000. I am concerned that as a result of states’ decisions not to expand Medicaid, federal taxpayers will pay more per enrollee who ends up in Marketplace coverage, but who would otherwise be eligible for Medicaid under the ACA. Can you please provide an updated analysis of the difference in federal costs, per enrollee, for an individual enrolled in Marketplace coverage and an analogous Medicaid enrollee?

Answer. CBO has not updated its analysis of costs per enrollee for Medicaid versus subsidies provided through exchanges per enrollee for comparable people. The agency intends to do so during the next few months and to release the results as soon as they are available.

**Senator Grassley**

**Question.** In conversations with my staff you have indicated that you are working on a conflict of interest policy that includes disclosures of potential conflicts from external consultants including those who provide input to the Panel of Health Advisors and the Panel of Economic Advisors. Will the documents submitted by these advisors be available to the Speaker of the House of Representatives, House Minority Leader, Senate Majority Leader, Senate Minority Leader or the Chair and Ranking Members of the House and Senate Budget Committees? If so, how? If not, please provide statutory authority for withholding documents from these officials.

**Answer.** Under its current policies, CBO considers whether members and potential members of CBO’s panels of advisers are engaged in political activity that might influence their perspective on issues for which CBO is seeking their advice. If someone is known to have accepted a political appointment or joined a political campaign, he or she is generally asked to leave the panel or is not asked to serve on it while that activity is taking place and, depending on the nature of the activity, for some period afterward.

In late 2014, CBO began the process of formalizing and expanding this practice into a policy that will involve systematic disclosure to the agency by panelists and people being considered for the panels of substantial political activity, significant consulting work directly related to the policy development work of the Congress, and other significant financial interests. The process of developing the policy is ongoing but has not been completed at this time; the agency is currently consulting with the staff of the budget committees about the details of the policy. The next meeting of one of CBO’s panels is scheduled for June 2015, and the agency intends to have the new policy in place before that date.

**Senator Perdue**

**Question.** Dr. Elmendorf, could you please provide the following information for the Senate Budget Committee—a projection of the yearly spending outlays from 2026 through 2046 for the following areas: 1. Net Interest, 2. Social Security, 3. Medicare and Medicaid, 4. Federal Share of Federal Employee Retirement.

**Answer.** CBO produces a *Long-Term Budget Outlook* annually. The supplemental data to the most recent volume, provided in the table below, show long-term projections of outlays as percentages of economic output for the following categories of spending: Social Security; Medicare; the combination of Medicaid, the Children’s Health Insurance Program, and
Projected Spending Under CBO’s Extended Baseline as of July 2014

Percentage of Gross Domestic Product

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<th>Fiscal Year</th>
<th>Social Security</th>
<th>Medicare</th>
<th>Medicaid, CHIP, and Exchange Subsidiesb</th>
<th>Other Noninterest Spending</th>
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Source: Congressional Budget Office.

Note: The extended baseline generally reflects current law, following CBO’s 10-year baseline budget projections through 2024 and then extending the baseline concept for the rest of the long-term projection period.

a. Outlays for Medicare represent net Medicare spending (gross Medicare spending minus offsetting receipts, primarily premium payments by Medicare beneficiaries).

b. Outlays for the category “Medicaid, CHIP and Exchange Subsidies” represent federal outlays for Medicaid, the Children’s Health Insurance Program, and health insurance subsidies provided through the exchanges established under the Affordable Care Act.

Exchange subsidies; other noninterest spending; and net interest. Federal spending on retirement programs for federal employees is included in the category of other noninterest spending and is not projected separately.

CBO’s most recent long-term budget projections are based on the agency’s April 2014 baseline. Updated long-term projections, based on CBO’s most recent 10-year baseline projections, will be available this summer.

**Question.** Dr. Elmendorf, on page 133 of “The Budget Economic Outlook: 2015-2025”, the CBO projected the impact on the deficit if real GDP growth is 0.1 percentage point lower per year than anticipated. Could you provide the impact to the deficit over the 10-year period if the real GDP increases by 0.5 percentage points and 1 percentage point greater than anticipated?

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**Answer.** If real (inflation-adjusted) growth in GDP was 0.5 percentage points higher for each of the next 10 years than CBO has forecast, the deficit would be about $1.6 trillion lower over that period; if annual real GDP growth was a full percentage point higher during that same period, the deficit would be about $3.3 trillion lower, CBO estimates.

Those estimates are extrapolations of CBO’s “rules of thumb”—that is, of the ways that economic changes might affect the agency’s baseline budget projections. Such rules provide a rough sense of how differences in individual variables, taken in isolation, would affect budget totals; they are not, however, substitutes for a full analysis of the implications of alternative economic forecasts. For example, a substantially different rate of economic growth would probably also affect many other economic variables, including interest rates and inflation.

CBO’s rules of thumb are roughly symmetrical, so an average growth rate of real GDP that is 0.1 percentage point lower than expected would have about the same budgetary effect as an average growth rate that is 0.1 percentage point higher. In addition to being symmetrical, the rules are also roughly scalable for moderate differences in growth rates, so a difference in economic growth five or 10 times larger than 0.1 percentage point corresponds to a change in the deficit that is five or 10 times larger, respectively.

**Senator Wyden**

**Question.** Americans’ paychecks have barely improved during the recovery and the December jobs report if anything represented a step back on the wage front. What does the CBO forecast hold for average wage growth over the next ten years? A decade from now, will middle class workers feel like they’ve gotten ahead and seen a rise in their standard of living? What does CBO foresee happening to the gap between average incomes and incomes at the very top of the distribution over the budget window? What policies do you think have the most promise for narrowing the income gap over time, without doing harm to the economy?

**Answer.** CBO projects stronger growth in hourly labor compensation over the next several years than was observed in 2014. That pickup is consistent with the agency’s projection of firms’ stronger demand for workers. To some degree, firms can attract unemployed or underemployed workers without increasing compensation. However, as slack in the labor market diminishes and firms must increasingly compete for workers, CBO projects that growth in hourly compensation will pick up. (When slack exists, labor resources are underused and many workers are unemployed or working fewer hours than they would like.) That increase in compensation will boost labor force participation (relative to what would otherwise occur) and thus the number of available workers, thereby moderating the overall increase in compensation growth.

Specifically, CBO expects the employment cost index for total compensation of workers in private industry to increase at an average annual rate of 3.6 percent from 2015 through 2019, compared with an average of about 2 percent over the past several years. The growth of other measures of hourly labor compensation, such as the average hourly earnings of production and nonsupervisory workers in private industries, is similarly expected to increase. CBO anticipates that earnings will grow faster for higher-income people than for others during the next decade—as they have for the past several decades.

Simultaneously achieving the goals of reducing inequality and not reducing economic output would be difficult and would generally involve a combination of policies. For example, the combination could include an increase in spending on federal programs for lower-income
people, or a reduction in taxes on such people, in ways that would strengthen incentives to work and save or that would increase the productivity of low-skilled workers. Such changes in fiscal policy would increase federal budget deficits and thereby reduce private investment over the long term, so other policy changes would be necessary to avoid reductions in economic output. Those additional policies would need to reduce spending or raise revenues in ways that discouraged work and saving or diminished productivity less than the positive effects for low-income people and low-skilled workers created by the other policies. Whether the net effect on incentives or productivity resulted in increased or decreased output would depend critically on the specifics of the policies involved. Other combinations of policies might also achieve those two goals.

**Question.** One of the core tenets of the Budget Control Act of 2011 (BCA), as you know, was the idea that if the so-called Super Committee failed, the resulting sequestration would be divided equally between defense spending and nondefense discretionary spending. That idea of parity is very important to many of us up here, so I just want to clear on this issue of fairness. To maintain the original intent behind the BCA, wouldn’t Congress need to keep defense spending within its BCA cap for FY 16 – and beyond – or to permit nondefense spending to exceed its cap by the same amount as the excess in defense spending?

**Answer.** Allowing either defense or nondefense discretionary funding to exceed the amounts prescribed in the BCA would require new legislation. In keeping with its mandate to provide objective and nonpartisan analysis, CBO does not attempt to assess whether new laws would be consistent with the intent of current law.

**Question.** Former Ways & Means Chairman Dave Camp and the Treasury Department have identified among the trillion dollars of tax expenditures that the tax treatment of derivatives is particularly inefficient and abusive. I know you are not allowed to advocate for specific policies, so let me ask this theoretically: is it possible for lawmakers to eliminate several of the most flagrant tax loopholes without compromising broader tax reforms goals of higher economic growth and improved efficiency? Follow-up: Can a tax reform proposal that broadens the tax base, lowers top tax rates, and raises revenue compared to baseline also boost economic growth?

**Answer.** In CBO’s view, it is possible for lawmakers to reduce some tax expenditures—that is, exclusions, deductions, preferential rates, and credits that cause revenues to be lower than they would otherwise be for any underlying structure of tax rates—while also improving economic efficiency and increasing economic growth. Likewise, it is possible for a comprehensive tax reform to broaden the tax base, lower top rates, raise revenues above the amounts projected in CBO’s baseline, and boost economic growth. However, the effects of reducing any tax expenditure and the effects of any comprehensive tax reform would depend upon the details of the policy changes. Regarding derivatives in particular, CBO has not analyzed the potential effects of changes to their tax treatment.

**Question.** Since 2010, CBO has continued to lower its future projections of spending by federal health care programs, including Medicare, Medicaid, CHIP, and coverage related provisions of the ACA. All the while, CBO has estimated that the number of uninsured Americans will decrease compared to its projections prior to 2010. Dr. Elmendorf, what impact has this slowdown in spending had on our annual deficits, national debt, and Medicare trust fund balance?
Answer. In August 2010, CBO projected that gross federal spending on the major health care programs over the 2013–2015 period would be $2.98 trillion. That category of spending includes Medicare (excluding receipts from premiums and certain payments from states), Medicaid, the Children's Health Insurance Program, and subsidies offered through health insurance exchanges and related spending. In January 2015, including the actual results for 2013 and 2014, the agency estimated that such spending would total $2.80 trillion over that three-year period, about $180 billion (or about 6 percent) less. That lower spending has decreased federal deficits and debt and bolstered Medicare's finances relative to CBO's earlier projection.

Moreover, CBO currently anticipates that federal health care spending in future years will also be below what the agency had previously projected. That change improves the outlook for deficits, debt, and Medicare's finances. For example, apart from the effects of legislation and revisions to the agency's economic forecast, CBO has revised downward projected federal spending for Medicare (net of premiums paid by beneficiaries and other offsetting receipts) and Medicaid between 2011 and 2020 by more than $1 trillion since the summer of 2010. Those revisions have reduced projected expenditures from Medicare's Hospital Insurance (Part A) trust fund. However, CBO and JCT also anticipate that the income flowing into that trust fund in future years will be below what the agency had previously projected because of lower payroll tax revenue. As a result, between August 2010 and January 2015 CBO revised its projection of that trust fund's balance in 2020 only slightly—from $195 billion to $208 billion.

Question. Over the past several years, annual Medicare spending growth has been at historically low levels. Does CBO believe this slowdown in the rate of growth compared to prior CBO projections is a temporary blip or a “level change” in spending trends? What impact has this slowdown had on our long-term budget picture, both in terms of just the Medicare program and also total federal spending?

Answer. CBO's projections of Medicare spending are subject to a considerable degree of uncertainty. A particular challenge currently is assessing the extent to which the recent slowdown in the growth of health care spending can be attributed to temporary factors such as the recession or, instead, to more enduring developments. Studies have generally concluded that some of the observed reduction in growth cannot be linked directly to the weak economy, although they differ considerably in their assessment of the relative importance of other factors. In August 2013, CBO released a paper that reviewed the observed slowdown in growth in Medicare spending between the 2000–2005 period and the 2007–2010 period.17 That review suggests that demand for health care by Medicare beneficiaries was not measurably diminished by the financial turmoil and recession and that, instead, much of the slowdown in spending growth was caused by other factors affecting beneficiaries’ demand for care and by changes in providers’ behavior.

Accordingly, over the past several years, CBO has substantially reduced its 10-year and long-term projections of spending per person for Medicare, and those reductions have also lowered CBO's projections of total federal spending. For example, over the past five years CBO has reduced its projection of Medicare outlays (net of premiums paid by beneficiaries and other offsetting receipts) in 2020 by about $120 billion, or about 14 percent, reflecting that slowdown. (That amount excludes revisions made in response to legislative action and to the

17. Michael Levine and Melinda Buntin, *Why Has Growth in Spending for Medicare Fee-for-Service Slowed?
economic outlook.) CBO projects that slower rates of growth will persist for some years to come, although the rate of growth in spending per person is expected to rebound somewhat from its recent very low level.

**Question.** CBO has continued to lower its projections for per-beneficiary Medicaid spending since 2010. How much lower is spending for Medicaid under the January 2015 baseline relative to 2010 and isn’t it the case that these reductions are primarily due to lower-than-previously projected per-beneficiary spending growth rather than the 2012 Supreme Court decision making health reform’s Medicaid expansion an option for states?

**Answer.** Since August 2010, CBO has lowered its projection of federal Medicaid outlays in 2016 from $416 billion to $360 billion. The change is the result of a collection of factors, including the effects of revisions to CBO’s economic projections, the Supreme Court decision that made the expansion of eligibility for Medicaid under the ACA optional for states, federal administrative actions, the availability of new data, and numerous improvements in modeling by CBO and the staff of the Joint Committee on Taxation.

Although the expansion of health insurance coverage enacted in 2010 is substantially increasing the number of Medicaid beneficiaries, CBO has reduced its 2016 projection of Medicaid spending per beneficiary. The slowdown in the growth of health care costs that has been experienced by private insurers, as well as by the Medicare and Medicaid programs, has been sufficiently broad and persistent to persuade CBO to significantly lower its projections of federal health care spending per beneficiary, although analysts’ views differ as to how much of the slowdown is attributable to the recession and its aftermath and how much to other factors.

**Question.** On p. 114 of the *Budget and Economic Outlook: 2015 to 2025*, CBO notes that it has revised down its estimate of corporate income tax receipts by $169 billion over ten years compared to its August 2014 forecast, owing to the increasing pace of international corporate tax avoidance strategies such as corporate inversions. Can you tell me how large—even just as an order of magnitude—is the anticipated revenue loss over ten years from corporations inverting or re-domiciling overseas? Next, can you tell me how much worse CBO feels the situation has gotten since the August forecast—that is, what portion of that $169 billion downward revision is roughly due to CBO’s expectation of a greater volume of corporate inversions over the budget window?

**Answer.** CBO expects that the corporate tax base will erode over the 2015–2025 period as a result of certain strategies that corporations will continue to follow to reduce their income tax liabilities. One strategy that erodes the corporate tax base is to decrease the share of business activity that occurs in C corporations (whose income is subject to the corporate tax) while increasing the share that occurs in pass-through entities such as S corporations (whose income is subject to the individual tax). Another strategy is to decrease the amount of income that is taxed in the United States through a combination of approaches, including corporate inversions and other actions, that allow an increasing share of income to be allocated to foreign affiliates rather than to their U.S. counterparts.18 CBO expects that the increasing

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18. Under a corporate inversion, a U.S. corporation can change its country of tax residence, often by merging with a foreign company. Inversions reduce U.S. corporate tax revenue both because the inverted U.S. corporation no longer must pay U.S. taxes on earnings in other countries and because a corporation can shift additional income out of the United States through the use of intercompany loans and the resulting interest expenses.
adoption of such strategies will result in progressively larger reductions in corporate income tax receipts.

As reflected in CBO’s baseline, corporate income tax receipts will be about 5 percent lower by 2025 than they would be without that erosion of the corporate tax base over the next decade. Slightly over half of that amount—about 3 percentage points, or $15 billion in 2025—stems from a combination of strategies that decrease the amount of income that is taxed in the United States.

Since releasing its baseline projections in August 2014, CBO has reduced its estimates of corporate income tax revenues by $169 billion over the 2014–2024 period to reflect technical factors—those unrelated to recently enacted legislation or to changes in the economic outlook. About one-quarter of that reduction reflects updated estimates of the effects of strategies, such as corporate inversion and other actions, that will decrease the amount of corporate income that is taxed in the United States.

**Question.** Dr. Elmendorf, I think all lawmakers are interested in better understanding how dynamic scoring is going to work going forward. To better educate us, I have three questions.

Based on my understanding of the House Rules package, major pieces of legislation will be given a conventional score broken out for each of the ten years in the budget window and a dynamic score, also broken out for each year, and the total score for a bill will be its conventional score plus its dynamic score. But House Rules are less clear on how the long-term budgetary impact of major legislation will be quantified – something we care very much about in the Senate owing to rules like the Byrd Rule meant to arrest legislation that might contribute to long-term fiscal profligacy. All that the House Rules say is that CBO and JCT will provide a “qualitative assessment” of the budgetary impact of the bill for the second and third decade. Can you tell us whether CBO and JCT will be able to give us an actual number or series of numbers for the cost of major legislation in the second and third decade? Or a percentage of GDP with a plus or minus sign? Please be specific in your answer.

Could CBO please provide us with a mocked-up example so that we better understand how these scores will be presented? Please have the example include conventional dynamic scores for the first ten years and the qualitative assessment for the second and third decades.

Can you help us understand how dynamic scoring will work in practice? For example, in terms of design, generally what would a major piece of legislation that is supposed to help students afford college need to do to receive a positive dividend as it were from a dynamic score? Generally, what would a bill that provides job training or expands apprenticeships need to do to receive such a positive dynamic score? Finally, what about a bill that cuts corporate tax rates and pays for the reduction by repealing accelerated depreciation and similar accelerated cost recovery provisions?

**Answer.** This year, the House of Representatives adopted a rule that requires CBO and the staff of the Joint Committee on Taxation to include the budgetary feedback of any macroeconomic effects of some major pieces of legislation in cost estimates for that legislation to the extent practicable. The rule instructs the agencies to include a quantitative estimate of that feedback in estimates for the next 10 years and a qualitative assessment of that feedback for the following two decades. The rule applies specifically to bills that would cause a gross

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19. Section 2(c) of H. Res. 5, adopted on January 6, 2015, added clause 8 to Rule XIII.
change in revenues or direct spending greater than or equal to one-quarter of 1 percent of GDP—an amount equal to about $45 billion in 2015—in any year during the next ten years. The rule does not apply to appropriation acts. The rule also states that the Chairman of the House Budget Committee may request that cost estimates for other legislation include macroeconomic effects as well. The rule will affect CBO’s presentation of estimates and analysis of different types of proposals.

**Presentation of Estimates.** An example of a possible summary table for a cost estimate that includes macroeconomic effects is shown below. However, CBO anticipates that the form in which the agency provides this information to the Congress will evolve over time depending on what sort of presentation seems most useful. Such cost estimates will include all of the information that typically would be included if macroeconomic effects were not incorporated in the analysis, as well as additional information related to the macroeconomic effects themselves and the uncertainty surrounding those effects. For example, if applicable, CBO would provide separate estimates for on-budget and off-budget effects, including macroeconomic effects to the extent possible. (Off-budget effects include changes in Social Security spending and revenues as well as in spending by the U.S. Postal Service.)

CBO expects that the specificity of the assessments that the agency will provide about the effects of legislation in later decades will vary depending upon factors such as the amount of time CBO has to conduct the analysis, the complexity of the legislation being considered, the capability of the tools that CBO has to assess the legislation’s effects, and the agency’s judgment about the uncertainty of the analysis.

**Summary of Estimated Budgetary Effects of H.R. X.**

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<tr>
<td><strong>Estimated Outlays</strong></td>
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<td><strong>Estimated Revenues</strong></td>
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<td><strong>Net Increase or Decrease (-) in the Deficit, Without Macroeconomic Effects</strong></td>
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<tr>
<td><strong>Budgetary Impact of Macroeconomic Effects</strong></td>
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Source: Congressional Budget Office.

Note: Cost estimates for legislation show estimated changes in direct spending and revenues that would result from enacting the legislation but not any estimated interest costs or savings arising from changes in the amount of borrowing by the federal government. To be consistent with that approach, the estimated effects on federal interest payments included in the budgetary impact of the macroeconomic effects of legislation reflect only the effects of changes in interest rates and exclude the effects of changes in the amount of borrowing.

a. Off-budget effects include changes in Social Security spending and revenues as well as in spending by the U.S. Postal Service.
A qualitative assessment of effects in later decades might look something like this:

- Including macroeconomic effects, CBO expects that the legislation would (increase/decrease) the deficit during the 2015–2025 period and would (increase/decrease) it in the following 10 years; those (increases/decreases) in the following 10 years would probably be (larger/smaller) than the ones projected for the 2015–2025 period.

In some situations, CBO might conclude that it has sufficient basis to provide some quantitative information about a subsequent decade, perhaps along the lines of one of the following:

- Including macroeconomic effects, the legislation would (increase/reduce) cumulative deficits by about 0.X percent of GDP over the decade following the 2015–2025 period.

- Including macroeconomic effects, the legislation would (increase/reduce) cumulative deficits by about $X billion over the decade following the 2015–2025 period.

**Analysis of Different Types of Proposals.** CBO has not analyzed the macroeconomic effects of proposals to help students pay for a college education, to provide job training, or to change the taxation of business income. In general, the estimated effects of a legislative proposal on budget deficits will be more favorable if the proposal is expected to lead to greater economic output, holding all else equal.

Broadly speaking, increases in federal spending tend to boost output in the short term by boosting total demand for goods and services. In the long term, increases in federal investment—spending in categories such as physical capital, education and training, and research and development—tend to have two sorts of effects on economic output. Increased federal investment—if not offset by decreases in other spending or increases in taxes—raises government borrowing, which tends to “crowd out” private investment, lowering output in the long term. However, increased federal investment also raises productivity in various ways, which tends to boost output in the long term—although considerable uncertainty exists about the size and timing of the increase in output that results. (Funding for federal investment is usually provided in appropriation bills, which are not covered by the House rule.) Thus, the macroeconomic effects of increases in federal investment would depend on the specific nature of the investment, and the net effects in the long term might differ from those in the short term.

Changes in tax policy that would not affect deficits but would change some tax rates could also affect output, and macroeconomic modeling by JCT and CBO incorporates such effects. For example, changing effective marginal tax rates would affect output: Lower marginal rates tend to increase output, and higher rates tend to reduce output. Moreover, economic activity is affected not only by the rates at which capital investments are taxed but also by how uniformly such investments are taxed. If some capital investments receive more favorable tax treatment than others, additional resources will be directed to those types of investment even if other types would be more productive. Thus, changing the uniformity of taxation can potentially affect productivity and output: Increased uniformity would tend to increase output, and less uniformity would tend to reduce output. The ultimate effect would depend on the specifics of the policy.
Question. Last year, Congress acted to modify the TANF program to account for scoring changes related to the TANF baseline. It is unclear to me when CBO notified Congress of these changes and which Committees received notification. What is the process by which CBO notifies Members of Congress when scoring projections of specific programs are expected to change? I understand that the major budget projections are typically issued in January and updated in August of each year, but for smaller programs or program subsets, is there a formal process through which Members and Committee of jurisdiction are notified of updating scoring techniques or projections? Specifically: Which Committees are notified? Is there a standard time frame CBO uses when making such notifications (e.g., CBO notifies Congress at least one year in advance of the scoring change coming into effect)?

Answer. CBO usually publishes three sets of baseline projections each year (in the winter, spring, and summer), all of which are released publicly. In general, for the year following the publication of the spring baseline, CBO estimates the costs of legislation using that baseline. It is relatively rare to have a change in baseline treatment for an existing program because the rules governing construction of the baseline are established in law. Nonetheless, new legislation, actions by the Administration, or new information concerning individual programs can sometimes lead to conceptual changes in the baseline projections that CBO prepares.

When CBO is considering a significant change in scoring procedures, or in the way that it will approach baseline projections for a particular program, the agency consults with the Senate and House budget committees and then promptly informs the budget committees and the committees of jurisdiction about any significant change that is made. There is no standard time frame for such notifications; however, CBO attempts to give as much notice as possible when such changes will cause projections of future spending to deviate significantly from the most recent baseline projections. Because CBO does not change the baseline used for budget enforcement purposes during the course of a legislative session (except to update for enacted legislation, certain court rulings, and any definitive new administrative actions such as final rules), the agency has generally informed committees about significant forthcoming conceptual changes before completion of a new set of baseline projections.

When each set of baseline projections is completed, detailed reports showing projections for each budget account are provided to budget committee staff and to any other Congressional staff who request such information. For example, such account-level reports are generally circulated (often by budget committee staff) to the staff of other committees, showing the baseline projections for programs within each committee’s jurisdiction. In addition, CBO’s analysts communicate regularly with staff on the budget committees, authorizing committees, and appropriations committees.

In the case of the Temporary Assistance for Needy Families (TANF) program, CBO changed its baseline projection in February 2014 for two aspects of the baseline: Welfare Research Grants and the TANF Contingency Fund.

Welfare Research Grants. The Social Security Act authorizes TANF and Welfare Research Grants. TANF provides cash assistance, work support, and other services to some low-income families; the Welfare Research Grants program supports research about TANF. Lawmakers provided about $17 billion in funding for TANF and $15 million for Welfare Research Grants in fiscal year 2014 and the same amounts for most of the years in the decade before
that. Those programs had been scheduled to expire numerous times over the past decade and were extended and provided with additional funding. In fiscal year 2015, lawmakers provided about the same amount of funding for TANF as in the previous year but did not reauthorize Welfare Research Grants as a separate program and instead set aside $15 million for research from TANF’s funding.

In baselines prior to the one published in February 2014, CBO considered Welfare Research Grants to be part of the TANF program, even though spending for the research grants appears in a different Treasury account within the budget. But in the latter part of 2013, after observing that the Welfare Research Grants were subject to sequestration but TANF was not, CBO concluded that Welfare Research Grants should be considered a separate program. That distinction was important for the baseline projections because the Balanced Budget and Emergency Deficit Control Act of 1985 states that if a mandatory program is scheduled to expire and is expected to have outlays greater than $50 million in the last year of authorization, it should be assumed to continue in the baseline. Thus, when the Welfare Research Grants account was considered to be a part of TANF, it was assumed to continue in CBO’s baseline, along with other funding for TANF; as a separate program, its funding was assumed to cease. If a program is assumed to continue in the baseline, then a cost estimate for its extension reports no net effect on the deficit. If a program is assumed to cease in the baseline, then a cost estimate reports that the deficit would increase if it was extended. When proposals for extensions of TANF and Welfare Research Grants were considered after February 2014, CBO estimated a cost of $15 million for extending the research grants for one year.

Because the change to the treatment of the Welfare Research Grants program was conceptual, CBO first consulted—in September 2013—with the staff of the Senate and House budget committees. As the staff of the budget committees raised no concerns, CBO then communicated its intention to change the baseline to the staff of the Senate Committee on Finance and the House Committee on Ways and Means, also in September 2013.

*TANF Contingency Fund.* CBO’s February 2014 baseline also reflected a reduction in projected budget authority for the TANF Contingency Fund. Authorization for the Contingency Fund was scheduled to expire at the end of fiscal year 2014, but CBO’s baseline incorporated the assumption that it would continue (again, consistent with the rules established by the Deficit Control Act). The baseline projections for the Contingency Fund were based on the expected outlays for the current year, which is the same assumption that CBO had used when the fund was previously set to expire at the end of fiscal year 2009. However, projected spending from the fund in 2014 had been reduced by about $14 million because some states had not spent the funds that had been allocated to them. Therefore, CBO reduced its baseline projection for each subsequent year by that amount. In that case, CBO changed its estimate of future spending but not the methodology for projecting funding for the expiring program. CBO’s projections of spending for almost every budget account change at least a bit from one baseline to another, and committees are not notified of such changes in advance.

**Senator Corker**

**Question.** Director Elmendorf, in 2009 you sent an analysis to Congress about how provisions within the Affordable Care Act would impact the premiums for Americans. In that analysis you discussed the impact on premiums for those individuals who would be purchasing insurance on the exchange, in the nongroup or individual market. In your
analysis, you stated that the estimate for “the average premium for new nongroup policies would be about 10 percent to 13 percent higher in 2016 than the average premium for nongroup coverage in that same year under current law.” You go on to state that this figure is based on the fact that new mandates and regulations for specific levels of coverage would increase average premiums by 27 to 30 percent in 2016, absent the mitigating factors you cite, such as your assumption that young and healthy people would enroll. Do you agree that this analysis suggests that if Congress was looking for ways to reduce the cost of insurance due to the Affordable Care Act, reducing the mandates and regulations could give Americans as high as a 30 percent discount?

**Answer.** The extent of coverage that an insurance policy provides is an important determinant of its premium. Because people often purchased less extensive coverage in the nongroup market under prior law, reducing the federally mandated scope and actuarial value of insurance coverage could reduce premiums in that market substantially. (The actuarial value is the share of costs for covered benefits that an insurance plan pays, on average; plans at the “silver” level specified in the ACA have an actuarial value of about 70 percent, for example.) The amount of the reductions in premiums would depend critically on the details of any alternative, however, and those reductions would probably cause corresponding increases in the average out-of-pocket costs that enrollees incur when they receive care (although the precise ways that insurers and enrollees might respond are difficult to predict). By contrast, in the market for group or employment-based coverage—which accounts for about 85 percent of the private insurance market—the effects on premiums of changing those provisions of the ACA would probably be small or negligible because such coverage generally met the ACA’s requirements before that law was enacted or is exempt from them.

In 2009, CBO estimated the effects on premiums of a proposal that was very similar to the ACA. At that time, the agency found that the provisions of that proposal governing the scope of benefits provided and the actuarial value of the coverage would increase average premiums for policies sold in the nongroup market in 2016 by between 27 percent and 30 percent, holding other factors equal. Although the effects of the ACA as enacted were expected to be similar, and CBO has continued to track nongroup premiums, the agency has not updated its estimate of the impact on those premiums (relative to those under prior law) and doing so would involve taking into account a broad range of factors that have affected the path of premiums in the interim. For example, overall growth in health care spending has been much slower than CBO had expected in 2009, and insurers have been more aggressive than CBO anticipated in designing nongroup plans with limited networks of providers to minimize their costs and premiums.

Reducing the required scope of benefits or actuarial value would reduce nongroup premiums, on average, but the effects would depend on the specific features of the proposal and the ways in which its provisions would interact with other aspects of current law. In particular, many enrollees in nongroup coverage now receive subsidies that limit the share of income they have to pay for coverage when they purchase a specified “silver” plan, so a proposal would need to specify whether and how such subsidies were provided—because that would affect how much people pay for coverage and what type of coverage they choose.

Reducing the extent of required benefits and actuarial values also would increase the amounts that enrollees have to pay for their care out of pocket, on average, by amounts roughly corresponding to the decrease in premiums. However, the effects on specific individuals would depend upon their use of health care services. Although premiums for plans offering less extensive coverage would probably be lower for all enrollees, people who used more health care services would tend to pay more in premiums and out-of-pocket costs combined, whereas people who used fewer health care services would pay less, on average. Again, the extent of such effects would depend greatly on the specific features of any proposal to change regulations governing mandated benefits and actuarial values.

**Question.** As federal expenditures on healthcare reach an historic percentage of our increased outlays over the next 10 years, has there been any analysis on the corresponding trend regarding individual healthcare spending? In other words, as the federal government shoulders more and more of the healthcare burden, has individual out of pocket spending decreased at all?

**Answer.** CBO does not track national health expenditures (NHE) as closely as it analyzes the components of those expenditures that are directly relevant to the federal budget, but the NHE projections developed by the Office of the Actuary in the Centers for Medicare & Medicaid Services shed light on these questions. Those projections show that the share of costs paid by the federal government will increase over time; as a result, the share of costs paid privately will be smaller than it is today—though the dollar amount of those private payments is expected to rise.

Specifically, the Office of the Actuary’s projections indicate that the share of health care spending financed by businesses, households, and other private sources will decrease from about 59 percent in 2008 to about 52 percent in 2023, and the share that is financed by federal, state, and local governments will increase correspondingly from 41 percent to 48 percent—with nearly all of that increase reflecting a rise in the share of costs that is financed federally. The share of NHE that is paid either by private health insurance or through out-of-pocket payments made when care is received (but excluding premium payments) is also projected to decline, from about 46 percent in 2008 to about 42 percent in 2023.

A significant share of health care spending in the private sector is subsidized through provisions in the tax code, primarily through the tax exclusion for employment-based health insurance, which is not reflected in the reported totals for NHE. Because of that exclusion, most payments that employers and employees make for health insurance coverage are exempt from payroll and income taxes. CBO estimates that the federal cost, or tax expenditure, associated with that exclusion—including the effects on revenues from both payroll and income taxes—was roughly $250 billion in 2013, equal to nearly one-quarter of spending on private health insurance that year. Including those costs would increase the share of NHE that was financed by the federal government in 2013 by about 9 percentage points. Although

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CBO has not projected the costs of all subsidies for health care provided through the tax code, the agency estimated in 2009 and 2010 that the ACA and similar proposals would increase the federal government’s budgetary commitment to health care—defined as the sum of net federal outlays for health programs and tax preferences for health care.23

Question. Specifically, the new federal mandates and regulations imposed by the Affordable Care Act, have limited the ways insurance companies can differentiate their products and control the cost of healthcare. Deductibles now are one of the few tools available to companies to hold down premium prices, and as a result, higher deductibles are now common on the exchange. Have there been any studies that have looked at how consumers out of pocket costs have changed as a result of the implementation of this law?

Answer. Out-of-pocket costs for consumers depend partly on whether they have insurance and partly on the extent of the coverage they have. A variety of studies have tried to examine changes over time in out-of-pocket payments and cost-sharing requirements. For example, as noted above, the Office of the Actuary at CMS develops estimates and projections of national health expenditures, including out-of-pocket payments that consumers make when they receive care. According to its most recent analysis, “out-of-pocket expenditures [were] projected to decline by 0.2 percent [in 2014], largely because of expanded insurance coverage” through Medicaid and nongroup plans purchased via health insurance exchanges (also known as marketplaces).24

Comparing the deductibles for exchange plans with deductibles for plans offered in the nongroup market under prior law is challenging because a number of factors may affect any differences that are observed. Exchange plans generally offer coverage with an actuarial value that equals or exceeds 60 percent, which is roughly the average actuarial value of coverage that was typically purchased in the nongroup market previously.25 That finding suggests that the deductibles for exchange plans may often be lower than was typical in the nongroup market (though higher than was typical in group or employment-based coverage). At the same time, there has been a general shift toward plans with higher deductibles in private insurance markets, which would have to be factored into any analysis of the ACA’s effects. According to one recent survey, for example, the share of people under age 65 with private health insurance coverage who were enrolled in a high-deductible health care plan rose from about 23 percent in 2009 to about 34 percent in 2013.26 CBO expects that trend to continue but has not specifically analyzed the effects of the ACA on plans’ deductibles and other cost-sharing requirements.


