



## **Answers to Questions for the Record Following a Hearing on the Budget and Economic Outlook for 2017 to 2027 Conducted by the Senate Committee on the Budget**

*On February 1, 2017, the Senate Committee on the Budget convened a hearing at which Keith Hall, Director of the Congressional Budget Office, testified about CBO's report The Budget and Economic Outlook: 2017 to 2027 ([www.cbo.gov/publication/52370](http://www.cbo.gov/publication/52370)). After the 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 budgetary impact of repealing the Affordable Care Act was briefly discussed during the hearing, but not with respect to any specific legislative proposal. As you are aware, CBO has prepared a number of estimates of the budgetary effects of H.R. 3762, the Restoring Americans' Healthcare Freedom Reconciliation Act of 2015. In CBO's most recent cost estimate of that legislation (released on January 4, 2016), what was the estimated impact of that legislation on the federal deficit? Please clarify what CBO's conclusions were regarding the budgetary impact of H.R. 3762 with and without macroeconomic feedback effects.

**Answer.** On January 4, 2016, CBO released an estimate of the budgetary effects of H.R. 3762, the Restoring Americans' Healthcare Freedom Reconciliation Act.<sup>1</sup> That estimate included two components—one that did not include the effects of any feedback to the budget from economic changes brought about by the bill (that is, the economic variables underlying the estimate were held constant) and another that incorporated such macroeconomic feedback.

Before accounting for macroeconomic feedback, CBO and the staff of the Joint Committee on Taxation (JCT) estimated that enacting H.R. 3762 would have reduced deficits by about \$318 billion over the 2016–2025 period. That estimate reflects a \$1.4 trillion reduction in outlays partially offset by a \$1.1 trillion decrease in revenues.

After accounting for the effects of macroeconomic feedback on revenues and spending, CBO and JCT estimated that the legislation would have reduced federal deficits by a total

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1. Congressional Budget Office, cost estimate for H.R. 3762, the Restoring Americans' Healthcare Freedom Reconciliation Act, as passed by the Senate on December 3, 2015, and following enactment of the Consolidated Appropriations Act, 2016 (January 4, 2016), [www.cbo.gov/publication/51107](http://www.cbo.gov/publication/51107).

of \$516 billion over the 2016–2025 period. The largest estimated change stemming from macroeconomic feedback was an increase in revenues arising from an increased supply of labor and capital, which in turn would have boosted employment and taxable income.

**Question.** The longer we wait to reform Social Security, the more difficult it will be. In order for Congress to make sure benefits remain available over the long-term, we need to discuss all reform options, with everything on the table. What levers are available to Congress to shore up the solvency of the Social Security trust fund?

**Answer.** To improve the financial status of the Social Security trust funds, the Congress would have to increase income to the trust funds, reduce outlays, or do both. Additional income could be generated for the funds by, for example, increasing the Social Security payroll tax rate, the amount of earnings subject to the payroll tax, or the amount of Social Security benefits that are subject to the income tax. Options to reduce scheduled benefits typically fall under one of three general approaches: change the benefit formula, increase the full retirement age, or reduce the cost-of-living adjustments. In December 2015, CBO analyzed 36 policy options frequently proposed by policymakers and analysts, most of which would improve Social Security’s long-term finances.<sup>2</sup>

Although CBO has not updated its analysis of those options, the agency expects that updated estimates of the options’ long-term effects would be broadly similar to those reported in 2015. For example, CBO reported that gradually increasing the payroll tax rate by 3 percentage points over 60 years would improve the 75-year actuarial balance, measured as a share of gross domestic product (GDP), by 0.5 percentage points, as would gradually reducing benefits by 15 percent for newly eligible beneficiaries over 10 years, starting in 2023.<sup>3</sup> Each of those options would eliminate about one-third of the shortfall in the program’s finances.

By itself, no individual option that CBO examined would create long-term stability for the Social Security program. Some options would affect all workers or beneficiaries similarly; others would have widely disparate effects, depending on a beneficiary’s year of birth or lifetime earnings. The effects of many of the options could be changed if they were implemented on a larger or smaller scale or phased in more slowly or quickly, although the resulting effects would not necessarily be proportional to the results presented in the report. If the goal was to address Social Security’s long-term imbalance, it would be necessary to combine several of the options that CBO analyzed. However, the effects of several policy changes implemented together are not always equal to the sum of the individual effects of those policy changes.

**Question.** According to the recently released January 2017 CBO baseline, the Government is expected to spend nearly one trillion dollars (\$997 billion) over the budget window (FY 18–FY 27) in order to meet obligations of the Federal Civil Service Retirement and Disability Fund (CSRDF), the trust fund that accounts for obligations to make annuity payments to retired federal civilian workers.

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2. See Congressional Budget Office, *Social Security Policy Options, 2015* (December 2015), [www.cbo.gov/publication/51011](http://www.cbo.gov/publication/51011).

3. The actuarial balance is the sum of the present value of projected tax revenues and the current trust fund balance minus the sum of the present value of projected outlays and a year’s worth of benefits at the end of a given period. A present value is a single number that expresses a flow of future income or payments in terms of an equivalent lump sum received or paid at a specific time.

Is it the case that the CSRDF resembles the Social Security trust funds, in that it holds no actual financial assets—except for Treasury IOUs—with which to pay this trillion dollars?

Although taxpayers fund the majority of the cost of federal employees' annuities, the employees themselves pay a share of the cost (which is spent each year by the Government). How much does CBO expect federal employees to pay the Treasury from FY 18–FY 27, as their contribution toward the cost of their future annuities?

If Congress were to increase that federal employee contribution rate on a forward-looking basis only—with the increase only applicable to new hires—would the resulting deficit reduction achieved be much smaller in the ten-year budget window than it would be in subsequent decades?

**Answer.** Most assets in the Civil Service Retirement and Disability Fund—like all assets in the Social Security trust funds—are invested in special-issue U.S. Treasury securities. Inflows to the CSRDF come from contributions from federal employees and their employing agencies as well as transfers from the general fund of the Treasury. Annuity payments to beneficiaries account for almost all of the outflows from the fund.

All told, those inflows to and outflows from the fund are projected to balance out over the long term—that is, unlike the Social Security trust funds, the CSRDF is not in danger of being exhausted. But a significant part of the fund's annual income comes from the general fund in the form of interest payments and an annual payment to cover the unfunded liability of the Civil Service Retirement System. (The current Federal Employees' Retirement System is required by law to be fully funded.) The cash to make the benefit payments that are not covered by annual contributions from employees and their employing agencies has to be generated each year through taxes, income from other government sources, or borrowing from the public.

From 2018 through 2027, federal employees will pay \$52 billion to the CSRDF for retirement benefits, CBO estimates. Their contributions to the fund are counted as revenues to the federal government, whereas federal agencies' contributions are intragovernmental transfers—not revenues—and thus have no effect on the government's budget deficit.

The Middle Class Tax Relief and Job Creation Act of 2012 increased the contribution rate from 0.8 percent to 3.1 percent for most employees hired after December 31, 2012, and the Bipartisan Budget Act of 2013 further increased the contribution rate to 4.4 percent for most employees hired after December 31, 2013. As a result, employees' annual contributions as a percentage of the fund's annual outlays are, under current law, projected to increase over time—and to continue increasing beyond the 10-year budget window—as the number of employees paying at the higher rate increases.

If the Congress raised the employee contribution rate for new hires, the associated increase in revenues—like those associated with previous contribution changes—would grow over time, so the increase from 2018 to 2027 would be smaller than the increase over future periods of the same length. However, all else being equal, that growth would slow down and eventually stop as current employees (who contribute at the lower rate) left the federal workforce and were replaced by new employees (who would contribute at the higher rate), but that would not occur for several decades.

### Ranking Member Sanders

**Question.** In January 2017, CBO estimated that repealing portions of the Affordable Care Act—specifically, repealing the mandate penalties and subsidies of the Act while leaving the popular market reforms in place, as has been proposed by Republicans for the FY 2017 Budget Reconciliation bill—would rip health coverage away from 32 million Americans and cause health insurance premiums in the individual market to double by 2026.

It is my understanding that if the Affordable Care Act is repealed, the change in law will be reflected in CBO's baseline budget projections as well as projections of health insurance coverage in the population and the cost of health insurance premiums. Measured against such a baseline, where millions of Americans have been stripped of coverage and premiums have skyrocketed, so-called plans to "replace" the Affordable Care Act may appear to increase the number of insured individuals and decrease health insurance premiums.

These estimates could significantly misrepresent the true net effect of repealing and replacing the Affordable Care Act, which is that fewer people would have health coverage and health insurance would become more costly than under current law. Opponents of the Affordable Care Act, including the President, have said their replacement plans will result in greater numbers of insured with lower costs for consumers compared to the Affordable Care Act. It is important that everyday Americans as well as Members of Congress are able to see a comparison of these replacement plans against the Affordable Care Act made by the independent, nonpartisan Congressional Budget Office.

If the Affordable Care Act is repealed, will CBO work with interested parties to compare the effects of any replacement plans on Americans' health care coverage and costs relative to what Americans had when the Affordable Care Act was law and what they would have had if the law was still in effect?

**Answer.** Yes. If requested to do so, CBO would, to the extent practicable, prepare such an analysis.

**Question.** The non-partisan Tax Policy Center (TPC) has estimated that the House Republicans' "Better Way" tax reform plan would reduce revenue by \$3.1 trillion over a decade. TPC also found that even when using so-called "dynamic scoring," the plan would still increase the national debt by at least \$3 trillion over a decade.

The House GOP claims its tax plan to be deficit-neutral, apparently based on estimates from the conservative Tax Foundation, which believes the plan would have far more dramatic macroeconomic effects.

But Congress relies on estimates from the Joint Committee on Taxation (JCT) which typically produces macroeconomic analyses that are much closer to those of the Tax Policy Center than the Tax Foundation.

Do you believe JCT's macroeconomic analysis of tax bills (which is incorporated into CBO's analysis) is the most accurate available? Do you believe Congress and the public should rely on JCT's estimates of the impacts of tax reform proposals, or do you think Congress should ignore JCT and look instead to an outside group like the Tax Foundation?

**Answer.** For many years, CBO has worked closely with the staff of the Joint Committee on Taxation and has found their analysis to be well-researched, thoughtful, and objective.

**Question.** Over the next decade, CBO projects that we will collect tax revenue equal to 18.2 percent of GDP. Federal outlays have exceeded that level in all but five years in the past five decades. This includes every year of the Reagan administration, every year of the George H.W. Bush administration, and all but one year of the George W. Bush administration.

In your opinion is it feasible for Congress to balance the budget without raising taxes at all, given that spending would have to come down to levels that are all but unprecedented in the past 50 years to achieve that?

**Answer.** Balancing the federal budget by the end of 2027 without raising taxes is possible, but it would require policymakers to reduce spending significantly. For example, all else being equal, if the Congress reduced noninterest spending by about 2.1 percent in 2018 and by an additional 2.1 percent in each subsequent year (so that noninterest spending was 4.2 percent lower than the baseline amount in 2019, 6.3 percent lower than the baseline amount in 2020, and so on), the budget would be balanced by the end of 2027. The reductions in noninterest spending would total about \$5.9 trillion over the 2018–2027 period (growing from \$80 billion in 2018 to about \$1.2 trillion in 2027). That reduction in spending would lower federal borrowing and thus reduce interest payments over the period by about \$600 billion. Under that illustrative scenario, total spending in 2027 would equal about 18.3 percent of GDP—lower than the 50-year average of 20.3 percent and lower than it has been since 2001.

In general, to balance the budget, lawmakers would have to significantly change tax policies to increase revenues above what they would be under current law, substantially alter spending policies to reduce outlays for large benefit programs below the projected amounts, or adopt some combination of those approaches.

**Question.** CBO projects that after 2020 federal revenue stemming from the corporate income tax will decline as a share of GDP. Your report explains that there are many reasons for this, but part of the explanation is schemes like corporate inversions that are used by American corporations to avoid paying U.S. taxes.

Especially in light of your remarks during today's hearing, in which you referred to the erosion of our tax base by parking profits offshore, should Congress try to raise revenue by closing the loopholes that allow this corporate tax avoidance?

A 2016 GAO study produced at my request found that the share of large, profitable corporations in the U.S. paying nothing in federal income taxes was 19.5 percent in 2012 and 24.1 percent in 2011. That GAO study also found that the *effective* rate paid by large, profitable U.S. corporations from 2008 through 2012 was 14 percent.

In light of this, do you believe we are overly burdening our corporations with taxes?

**Answer.** In keeping with the agency's mandate to provide objective, impartial analysis, CBO does not make recommendations. Therefore, it takes no position on whether the Congress should attempt to raise additional revenues by closing loopholes in the corporate tax code or whether the corporate income tax burden is too high or too low.

In *The Budget and Economic Outlook: 2017 to 2027*, CBO projected that under current law, corporate income tax receipts would rise from 1.7 percent of GDP in 2017 to 1.8 percent in 2020 and then gradually decline to 1.6 percent of GDP by 2027. That pattern over the next decade is the net effect of a number of factors, including an expected increase in the use of certain strategies that many businesses and investors employ to reduce their tax liabilities. One such strategy is for firms to organize their business activity in a way that reduces income that is subject to the corporate income tax. For example, a business may split its business activity so that less of its income is subject to the corporate income tax, or a new business may choose to organize as an entity that is subject only to the individual income tax. Another strategy is to increase the amount of corporate income that is shifted out of the United States through a combination of methods such as setting more aggressive transfer prices, increasing the use of intercompany loans, or undertaking corporate inversions.

Even though corporations remit the tax payments, the burden of corporate income taxes is ultimately borne by households. In its analyses of the distribution of household income and federal taxes, CBO allocates 75 percent of corporate income taxes to households in proportion to their share of capital income (that is, income from interest, dividends, adjusted capital gains, and rents) and the remaining 25 percent to households in proportion to their share of labor income. In its most recent report on the subject, CBO estimated that households in the top 20 percent of the before-tax income distribution bore almost 80 percent of corporate income taxes.<sup>4</sup> Even within that group, the burden is distributed disproportionately: Households in the top 1 percent of the income distribution bore 47 percent of the corporate tax burden.

**Question.** Last week, Congressman Mulvaney—the President’s nominee for OMB Director—told this Committee that he doubted what climate scientists have now almost universally concluded, which is that humans are contributing to climate change. He also expressed doubt in how, or even if, climate change impacts the federal budget.

GAO began looking into the budgetary effects of climate change several years ago, and CBO has started doing the same.

The reason for this is simple: Climate change has a huge impact on the federal budget. It affects our national security infrastructure, especially military installations close to shorelines, our transportation infrastructure, the cost of flood insurance, of crop insurance, and of our response to natural disasters.

Director Hall, can you outline some of the ways climate change impacts the federal budget?

Moreover, as information pertaining to climate change has disappeared from the websites of the White House and the EPA, can you commit that reports on the subject will remain available at [cbo.gov](http://cbo.gov)?

**Answer.** Climate change may affect the federal budget in several ways—not only through mandatory spending programs (such as federal crop insurance and the National Flood Insurance Program) and discretionary spending programs (such as postdisaster relief for

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4. See Congressional Budget Office, *The Distribution of Household Income and Federal Taxes, 2013* (July 2016), [www.cbo.gov/publication/51361](http://www.cbo.gov/publication/51361).

hurricanes and wildfires) but also by changing the nation's economic output, which in turn affects federal spending and tax receipts.

Under the rules governing baseline projections, some of the potential budgetary effects of climate change can be reflected in the baseline, but some cannot. 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 land use and crop yields, which may be affected by climate change.

For discretionary spending that is affected by weather-related disasters, such as spending by the Disaster Relief Fund operated by the Federal Emergency Management Agency, CBO is required to apply a different treatment. As specified by law, CBO's 10-year baseline projections reflect the assumption that the amount of discretionary funding appropriated for a particular program or activity will grow from the amount provided in the current year at the rate of inflation. (The baseline also incorporates the assumption that total discretionary appropriations are constrained by the caps imposed by the Budget Control Act of 2011, as amended.)

The Congress has typically responded to large-scale weather-related disasters, such as Hurricanes Katrina and Sandy, by enacting legislation to increase spending—providing emergency supplemental appropriations for disaster relief, for example. If climate change led to more severe or more frequent weather-related disasters in the future, lawmakers might spend more on such appropriations than would otherwise be the case. For example, damage from storm surges might lead the Congress to pass additional emergency supplemental appropriations for disaster relief or to provide funding to protect vulnerable infrastructure. Alternatively, the Congress might amend existing laws in order to limit federal spending on weather-related disasters—for instance, by increasing the share of postdisaster assistance for which states and localities are responsible. However, in accordance with the rules that govern such projections, CBO's baseline projections reflect the assumption that current laws will remain in place, so they cannot account for legislative changes that might increase or decrease such spending in the future.

Climate change may also affect the nation's economic output and, consequently, federal tax revenues. However, researchers estimate that those effects will probably be very small in the near future. For example, one recent study found that over the 2020–2039 period, the effect of climate change on outdoor workers' productivity would probably be between an increase of 0.03 percent and a decline of 0.38 percent. (Such estimates are very uncertain.) In addition, CBO has concluded that changes in the frequency of major hurricanes could have persistent negative effects on economic output, but only if climate change made such storms frequent enough that the economy was unable to fully recover from one catastrophic storm before it was hit by another. In contrast, CBO has concluded that, over the long run, a single hurricane would have no significant impact on the nation's GDP. That conclusion reflects the fact that, in the long run, GDP is determined by the size of the capital stock (which is determined by capital across the country, national saving, and capital inflows, none of which are likely to be permanently affected by one hurricane) and by the labor supply and technological progress (which are also unlikely to be permanently affected).

After publishing a report about hurricane damage and the federal budget last year, CBO is currently examining the fiscal viability of the National Flood Insurance Program.<sup>5</sup> That analysis draws upon the most recent estimates of flood risk under current conditions. CBO is also currently assessing the federal crop insurance program by qualitatively analyzing factors—such as weather and the long-term implications of climate change—that affect the government’s budgetary costs. When CBO completes those reports, it will make them publicly available on the agency’s website; CBO’s past reports will remain available on the website.

**Question.** According to CBO’s January 2017 baseline, the Federal Student Loan Program continues to make a profit off of student loan borrowers. Excluding administration costs, the student loan program is projected to generate more than \$110 billion in profits for the federal government over the next ten years, an increase of more than \$30 billion from CBO’s January 2016 baseline.

Last Congress, I introduced legislation that would lower student loan interest rates for new borrowers and allow existing borrowers to refinance their loans to those lower rates. The bill also helps end the shameful practice of the federal government generating a profit off of student loan borrowers.

In part, my bill lowers student loan interest rates by basing student loan interest rates on the 91-Day Treasury Bill instead of the Ten-Year Treasury Note—a practice that was in place under Presidents Clinton and George W. Bush. According to your testimony and CBO projections, the 91-Day Treasury Bill is projected to have lower interest rates over the next decade than the Ten-Year Treasury Note.

If Congress were to tie student loan interest rates to the 91-Day Treasury Bill instead of the Ten-Year Treasury Note and made no other changes to the student loan program, would student loan interest rates be lower for students next year? How about over the next ten years?

Would moving to the 91-Day Treasury Bill decrease the profits the federal government currently generates from the student loan program?

**Answer.** Under current law, the interest rates paid by borrowers on federal student loans disbursed between fiscal years 2017 and 2027 are based on the 10-year Treasury note and fixed for the term of the loan. If instead interest rates were based on the 3-month Treasury bill but were still fixed for the term of the loan, rates on loans originated in each of the next 10 years would, in CBO’s estimation, be lower than they would be under current law. Such a change would increase budget deficits because the government would receive less in interest payments from borrowers than it would receive under current law.

In every year of the next decade, the interest rate on 10-year Treasury notes is projected to exceed the rate on 3-month Treasury bills. In January 2017, CBO projected that the 10-year rate would grow from an average of 2.2 percent in fiscal year 2017 to 3.6 percent in fiscal year 2027. Over that same period, the agency estimated, the 3-month rate would grow from 0.6 percent to 2.8 percent.

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5. See Congressional Budget Office, *Potential Increases in Hurricane Damage in the United States: Implications for the Federal Budget* (June 2016), [www.cbo.gov/publication/51518](http://www.cbo.gov/publication/51518).

To project the costs of the federal student loan programs, CBO uses the procedures established in the Federal Credit Reform Act of 1990 (FCRA). Those procedures require that the lifetime cost of a federal loan be expressed as the present value of the loan on the date that it is disbursed. A present value is a single number that expresses current and future cash flows in terms of an equivalent lump sum received or paid at a specific time. The present value of a given set of cash flows depends on the rate of interest—known as the discount rate—that is used to translate those flows into current dollars. Under the rules specified in FCRA, the expected future cash flows related to loans administered under federal programs—including the amounts disbursed, all projected payments of principal and interest, and the projected losses resulting from defaults—are discounted using the rates on Treasury securities with similar terms to maturity. Using those procedures, CBO estimates that from 2017 to 2027, the federal student loan programs will yield a net *gain* to the government of \$73 billion.

The House and Senate budget resolutions also require CBO to provide supplemental estimates of the cost of federal credit programs on a fair-value basis, in which present-value estimates of cost are based on market values. Fair-value estimates differ from FCRA estimates in that they include the cost of the loans' market risk.<sup>6</sup> In practice, CBO accounts for the cost of market risk in its fair-value estimates by discounting expected future cash flows using market-based rates, which are generally higher than the Treasury rates used in FCRA. Using fair-value procedures, CBO estimates that from 2017 to 2027, the federal student loan programs will have a net *cost* of \$173 billion.

Although the projected cost of the student loan programs would increase regardless of the method used to calculate it if interest rates for student loans were based on the 3-month Treasury bill instead of the 10-year Treasury note, CBO expects that the reduction in the net gain projected under FCRA would be slightly smaller than the increase in the net cost projected using the fair-value method because of the difference in discounting.

### Senator Corker

**Question.** A steady progression of CBO directors has appeared before the Senate Budget Committee to warn members of the dangers associated with our failure to remedy the structural imbalance between revenues and expenditures in the federal budget. CBO's outlook reveals that the danger has not receded. Under current law, CBO predicts trillion dollar deficits will return—and stay—driven by unchecked spending on entitlements and tax expenditures. As a consequence, our debt burden will grow by nearly \$10 trillion over the next decade. The net result is a mountain of debt that must be repaid, not by our generation, but by our children and grandchildren. This fact pattern is both unsustainable and immoral.

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6. Market risk is the component of financial risk that remains even after investors have diversified their portfolios as much as possible. It arises because macroeconomic conditions (such as productivity and employment), as well as expectations about future macroeconomic conditions, change over time. Most credit programs expose the government to market risk because any losses incurred on its loans or loan guarantees would probably be concentrated in periods when the economy was weak and borrowers were unable to repay their loans. Incorporating the cost of the market risk associated with federal programs in estimates of the programs' costs aligns the government's valuation of the cost of the risk it bears with the market value of the cost of a similar risk borne in the private sector. For additional discussion, see Congressional Budget Office, *Fair-Value Estimates of the Cost of Selected Federal Credit Programs for 2015 to 2024* (May 2014), [www.cbo.gov/publication/45383](http://www.cbo.gov/publication/45383).

- a. Can we avoid harming future generations by balancing the federal budget and not adding to our debt, or is it necessary to go further—to run surpluses and actually pay down our debt?
- b. CBO often refers to our growing debt burden as “unsustainable.” What actually happens when a nation’s debt load reaches the tipping point and is no longer sustainable? Please describe the chain of events we can expect if we take no action to reduce our debt.
- c. Is it possible to stabilize our debt without addressing the growth in entitlement spending?

**Answer.** CBO has written frequently about the potential long-term consequences—both for the economy and for the federal budget—of high and rising debt.<sup>7</sup> It is up to lawmakers to decide on an appropriate target for the amount of federal debt, but it is clear that the ratio of debt to the size of the U.S. economy (debt as a percentage of GDP) cannot rise forever.

CBO has also studied how waiting to resolve the long-term fiscal imbalance would affect various generations of the U.S. population. In 2010, the agency compared economic outcomes under two policies: one that would stabilize the debt-to-GDP ratio starting in a particular year and another that would wait 10 years to do so.<sup>8</sup> That analysis suggested that generations born after the earlier implementation date would be worse off if the stabilization was delayed by 10 years. People born more than 25 years before that earlier implementation date, however, would be better off with delayed action—largely because they would avoid the effects of some or all of the policy changes needed to stabilize the debt. The cohort born between those two groups could either gain or lose from delayed action, depending on the details of the policy changes.

A large and continuously growing federal debt would increase the chance of a fiscal crisis in the United States. Specifically, investors might become less willing to finance federal borrowing unless they were compensated with high returns. If so, interest rates on federal debt would rise abruptly, dramatically increasing the cost of government borrowing.<sup>9</sup> That increase would reduce the market value of outstanding government securities, and investors could lose money. The resulting losses for mutual funds, pension funds, insurance companies, banks, and other holders of government debt might be large enough to cause some financial institutions to fail, creating a fiscal crisis. An additional result would be a higher cost for private-sector borrowing because uncertainty about the government’s responses could reduce confidence in the viability of private-sector enterprises.

It is impossible for anyone to accurately predict whether or when such a fiscal crisis might occur in the United States. In particular, the debt-to-GDP ratio has no identifiable tipping point to indicate that a crisis is likely or imminent. All else being equal, however, the larger a government’s debt, the greater the risk of a fiscal crisis.

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7. See, for example, Congressional Budget Office, *The 2017 Long-Term Budget Outlook* (March 2017), [www.cbo.gov/publication/52480](http://www.cbo.gov/publication/52480).

8. See Congressional Budget Office, *Economic Impacts of Waiting to Resolve the Long-Term Budget Imbalance* (December 2010), [www.cbo.gov/publication/21959](http://www.cbo.gov/publication/21959).

9. For more information, see Congressional Budget Office, *Federal Debt and the Risk of a Fiscal Crisis* (July 2010), [www.cbo.gov/publication/21625](http://www.cbo.gov/publication/21625). That report points out, for example, that during past fiscal crises, Argentina, Ireland, and Greece were forced to make difficult choices in the face of sharp increases in interest rates on government debt.

The likelihood of such a crisis also depends on conditions in the economy. If investors expect continued growth, they are generally less concerned about the government's debt burden. Conversely, substantial debt can reinforce more generalized concern about an economy. Thus, fiscal crises around the world often have begun during recessions and, in turn, have exacerbated them.

If a fiscal crisis occurred in the United States, policymakers would have only limited—and unattractive—options for responding. The government would need to undertake some combination of three approaches: restructure the debt (that is, seek to modify the contractual terms of existing obligations), use monetary policy to raise inflation above expectations, or adopt large and abrupt spending cuts or tax increases.

It may be possible to stabilize the debt—or at least to put it on a more sustainable path—without reducing spending for large benefit programs below the amounts projected in CBO's baseline; however, it would be difficult. If current laws generally remained the same, CBO projects, federal spending would grow from 20.7 percent of GDP this year to 23.4 percent in 2027; federal revenues would grow more slowly over that period—from 17.8 percent of GDP to 18.4 percent. About 70 percent of the growth in outlays over the next 10 years is attributable to just three sources: Social Security, Medicare, and net interest on federal debt. To avoid the negative consequences of high and rising federal debt and to put debt on a sustainable path, lawmakers would have to significantly change tax policies to increase revenues above what they are projected to be under current law, substantially amend spending policies to reduce outlays for large benefit programs below the projected amounts, or adopt some combination of those approaches.

**Question.** As Congress ponders a way to repeal and replace Obamacare, one idea is to repeal most of the payfors immediately (the tax increases) but maintain spending on the Obamacare premium subsidies, tax credits, and the expanded Medicaid program during a “transition period.” Under this plan, the transition could last as long as three years.

- a. How much would the deficit increase during a 3-year transition period?
- b. If Congress needed to extend Obamacare spending one year at a time after a 3-year transition period (an “ACA fix”), what would the estimated cost be for a one-year extension without offsets?

**Answer.** CBO's analytical resources have been dedicated to analyzing legislation for committees with jurisdiction over health care. Answering your questions would require substantial analysis, and the agency would be happy to turn to them at a later time. Although CBO has not analyzed a proposal with provisions identical to those you have asked about, the agency has prepared a cost estimate for a similar proposal to repeal portions of the Affordable Care Act (ACA) that included a two-year transition period.

During the 114th Congress, CBO and JCT estimated the budgetary effects of H.R. 3762, the Restoring Americans' Healthcare Freedom Reconciliation Act of 2015.<sup>10</sup> The bill would have

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10. Congressional Budget Office, letter to the Honorable Mike Enzi regarding the budgetary effects of H.R. 3762, the Restoring Americans' Healthcare Freedom Reconciliation Act, as passed by the Senate on December 3, 2015 (December 11, 2015), [www.cbo.gov/publication/51090](http://www.cbo.gov/publication/51090). CBO and JCT later updated those budgetary estimates following the enactment of the Consolidated Appropriations Act, 2016. See Congressional Budget Office, cost estimate for H.R. 3762, the Restoring Americans' Healthcare Freedom Reconciliation Act, as passed by the Senate on December 3, 2015, and following enactment of the Consolidated Appropriations Act, 2016 (January 4, 2016), [www.cbo.gov/publication/51107](http://www.cbo.gov/publication/51107).

immediately eliminated penalties associated with the requirements that most people obtain health insurance and that large employers offer their employees health insurance that meets specified standards. It would have also repealed or delayed many of the noncoverage revenue provisions included in the ACA. After a transition period of roughly two years, the bill would have eliminated the ACA's expansion of Medicaid eligibility and the subsidies available to people who purchase health insurance through the marketplaces established under the ACA. Accounting for macroeconomic feedback, CBO and JCT estimated that the bill would have increased federal budget deficits by \$27 billion in the first year following enactment (2016) and by \$6 billion in the second year (2017). (After 2017, CBO and JCT estimated, the bill would have reduced deficits; the total reduction over the 2016–2025 period was estimated to be \$516 billion.) The effects of a legislative proposal that was very similar to H.R. 3762 but had a three-year transition period would, CBO expects, probably exhibit a similar pattern—that is, the bill would increase deficits in each year during the transition period and reduce them thereafter.

Estimating the effects of extending policies governing health insurance one year at a time would be difficult. Decisions about offering and purchasing health insurance depend on the stability of the health insurance market, and it is not clear how federal agencies, state regulators, insurance companies, and potential purchasers of insurance would respond to the uncertainties that would prevail if the expiration of the ACA's provisions loomed each year, particularly because insurance companies have to set policy provisions and premiums for the coming year well in advance.

**Question.** On January 20, 2017 President Trump issued an Executive Order stating:

*To the maximum extent permitted by law, the Secretary of Health and Human Services (Secretary) and the heads of all other executive departments and agencies (agencies) with authorities and responsibilities under the [Patient Protection and Affordable Care] Act shall exercise all authority and discretion available to them to waive, defer, grant exemptions from, or delay the implementation of any provision or requirement of the Act that would impose a fiscal burden on any State or a cost, fee, tax, penalty, or regulatory burden on individuals, families, healthcare providers, health insurers, patients, recipients of healthcare services, purchasers of health insurance, or makers of medical devices, products, or medications. (Emphasis added.)*

What effect will this directive have on the way CBO scores legislation repealing provisions of the Affordable Care Act?

**Answer.** CBO's assessment is that, by itself, the executive order signed on January 20, 2017, does not take the sort of concrete or definite action that would lead the agency to update its current baseline projections. Hence, cost estimates for legislation related to the ACA will not be directly affected by the executive order, but actions taken by agencies to implement that order in the future and new orders that are more specific could affect CBO's estimates.

CBO will update its baseline for scoring legislation if the departments tasked with implementing the ACA (including the Departments of Health and Human Services, the Treasury, and Labor) take further specific actions. Such actions could include issuing proposed and final rules, guidance documents, or other official announcements that clearly indicate the Administration's intent to take a specific action.

### Senator Stabenow

**Question.** As you know, there has been a lot of talk about tax reform taking place this year. For several years I have been pushing for reform that would penalize companies and individuals who use tax loopholes to avoid paying their fair share. Just one example is an egregious loophole that allows businesses to deduct the cost of shipping American jobs overseas.

Of course, there is a broader problem in our international tax system, which is the ability of corporations to shift income out of the U.S. through inversions and other techniques. I hope to work with my colleagues on both sides of the aisle in the Finance Committee to reform taxes in a way that benefits all Americans, and not through reconciliation in the budget process.

Dr. Hall, in the CBO's report, you say there is "an expected increase in the use of [inversions, transfer prices, and intercompany loans] that many businesses and investors employ to reduce their tax liabilities." Could you tell us what you expect the impact of this tax avoidance will be on federal revenues, as well as the economy?

**Answer.** As stated in *The Budget and Economic Outlook: 2017 to 2027*, CBO projects that corporate income tax receipts will fall in relation to GDP over the coming decade. One reason for that projection is that CBO anticipates that multinational corporations will increasingly use strategies such as inversions, transfer pricing, and intercompany loans to shift their taxable income out of the United States. As CBO's recent report comparing corporate income tax rates around the world shows, corporate income is taxed at a higher rate in the United States than it is in the countries with which the United States conducts most of its trade.<sup>11</sup> The difference in those rates provides multinational corporations an incentive to engage in strategies that allow them to shift their profits overseas. CBO expects that the continued increase in the use of those strategies will not significantly change the amount of real economic activity that occurs inside the United States, so although such strategies are projected to reduce federal corporate tax revenues, they are not anticipated to have a significant effect on employment in the United States or on the U.S. economy more generally.

Overall, CBO projects that the continued erosion of the corporate tax base would result in corporate income tax revenues in 2027 that were about 5 percent lower than they would have been if that tax base did not erode any further than it already had as of 2016. About half of that erosion is attributable to a projected increase, relative to 2016, in corporations' use of strategies for shifting income out of the United States. The other half is attributable to the trend, which is expected to continue, of businesses' choosing to establish themselves as something other than a C corporation—a partnership, for example—so that their income is taxed under the individual income tax instead of under the corporate income tax.

**Question.** President Trump has already issued several executive orders, many of which will have a budgetary impact. Does CBO score executive orders or incorporate them into the baseline? If so, how does CBO decide when to score them? Does CBO plan to account for new, and often ambiguous, executive orders as they are issued by the new administration? When they do score executive orders, what is CBO's plan to make Congress aware of the current and future costs of these orders to inform the debate here in Congress?

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11. See Congressional Budget Office, *International Comparisons of Corporate Income Tax Rates* (March 2017), [www.cbo.gov/publication/52419](http://www.cbo.gov/publication/52419).

**Answer.** CBO does not prepare written estimates of the budgetary effects of nonlegislative actions such as executive orders; under the Congressional Budget and Impoundment Control Act of 1974, CBO prepares cost estimates only for legislation being considered by the Congress.

Executive orders might affect the baseline that CBO uses as a benchmark for measuring the budgetary effects of legislative proposals that would change current law. The agency's baseline is an estimate of what spending and revenues would be over the next 10 fiscal years if existing laws—and administrative policies for executing those laws—generally remained unchanged. If an executive order leads a federal agency to change its practices in a way that affects the budget, the estimated budgetary effects are incorporated into CBO's 10-year baseline projections of mandatory spending and revenues.

CBO has not updated its baseline to account for any of the 15 executive orders that the new Administration issued through February 2017. In CBO's judgment, many of those orders will not significantly affect the federal budget. Other orders could affect the budget if in response to them agencies modified their policies to achieve the Administration's goals for certain programs. CBO will update its baseline to account for any specific actions that affected agencies take.

In most years, CBO updates its baseline projections three times (usually in January, March, and August). However, because the Congress needs legislative cost estimates to be stable and predictable throughout a legislative session, the budget committees typically specify one set of projections as the "scoring" baseline that will be used throughout a given budget cycle. Those projections rely on assumptions about a variety of factors that are beyond the control of the Congress. For example, they reflect economic projections that underlie CBO's macroeconomic forecast (which includes variables such as interest rates, GDP, and prices for certain commodities) and technical projections (such as the rate at which agencies will spend funds and program participation rates). That baseline also reflects judgments about the likelihood and potential outcome of proposed or pending administrative actions (such as agencies' rulemaking), judicial proceedings, and actions that might be pursued by nonfederal entities.

To ensure the stability of estimates throughout the Congressional budget process, CBO—by long-standing convention—generally does not update its economic or technical projections in between baselines. But under certain circumstances, CBO may update the scoring baseline to take into account specific events that occur after it has been completed. If CBO determines that such a baseline update is warranted, the baseline projections used for scoring legislation are updated immediately to take the new circumstances into account. For example, CBO always updates the scoring baseline to reflect the enactment of new legislation. Updates to reflect other events, such as administrative actions and court decisions, are less common. When analyzing the potential effects of administrative actions, CBO distinguishes between proposed actions that are routine—that is, those that enable agencies to continue to execute programs as they currently do and that therefore do not affect baseline projections—and those that signal a change in the Administration's policy and thus may have budgetary effects.

Agencies often have significant discretion to change the manner in which they implement programs, and CBO's analysts must be aware of any changes in administrative policy that may be implemented—including those set forth in new executive orders—that would have significant budgetary effects. In carrying out guidance specified in executive orders, agencies

must frequently issue new rules or undertake other administrative actions to implement the Administration's new policy. The budgetary effects stemming from such policy changes depend on the details of those administrative actions. Therefore, CBO does not usually update baseline projections when the Administration issues an executive order; rather, it typically updates projections for affected programs only after agencies take specific administrative action.

Whenever CBO decides to update the scoring baseline for any reason, the agency notifies the House and Senate Budget Committees, the committees of both chambers that have jurisdiction over the affected programs or activities, and the sponsors of any pending legislation for which CBO has transmitted an estimate that may be affected by that update. If necessary, CBO also prepares revised estimates for such pending legislation to account for the change in the scoring baseline.

### **Senator Whitehouse**

**Question.** Since 2010, CBO has repeatedly lowered its projections for spending on the major federal health care programs. At today's hearing, you acknowledged that parts of the Affordable Care Act have helped to reduce the growth of federal health care spending. What position do you take on causative linkage between implementation of the ACA and these reductions? Which provisions of the ACA have helped to reduce the rate of growth for Medicare, Medicaid, exchange subsidies, and other federal health care programs? By how much? If you are still reviewing these questions and do not have answers, please describe your process and timeframe for pursuing these answers.

**Answer.** Gross federal spending on health care has increased as a result of the Affordable Care Act, primarily because of the expansion of eligibility for Medicaid that occurred under the law and the subsidies provided through the insurance marketplaces established under it. But provisions of the ACA have also reduced spending on Medicare. Although the growth of overall health care spending has slowed, and that slowdown is partially reflected in CBO's projections of federal spending over the next 10 years, it is difficult to separately identify how much of that slowdown was caused by the ACA. A number of factors suggest that the ACA's direct effect on health care spending may have been limited so far. Nevertheless, implementation of the ACA's provisions may have led to a focus on cost control that has caused growth in such spending to be slower than it would have been otherwise. Moreover, some of the ACA's provisions have not yet taken effect or are likely to have a greater impact on costs in the future than they have had to date. CBO could attempt to identify which provisions of the ACA are most likely to affect health care cost growth in the future, but whether and when such analysis can be undertaken will depend on the Congress's priorities for CBO's work in the health care area.

*Medicare.* In March 2010—shortly before the ACA was enacted—CBO projected that spending on Medicare, net of offsetting receipts, would total \$893 billion in 2020 (the last year of the 10-year projection made at that time). In the updated projections that it published later that year after the law was enacted, CBO estimated that the ACA would reduce Medicare spending in 2020 by 13 percent. The agency continues to view that estimate as reasonable in light of subsequent experience, although the actual reduction in spending through 2016 that resulted from enactment of the ACA cannot be identified because the relevant budgetary effects are embedded in other changes in the broader categories of Medicare spending. Most

of the projected decrease stemmed from reductions in annual updates to payment rates for services provided in the fee-for-service sector and from changes in payment formulas that reduced payment rates for Medicare Advantage plans below what they would have been had the ACA not been enacted.

CBO currently projects that net spending for Medicare in 2020 will total \$701 billion—21 percent less than the amount that the agency had projected in its March 2010 baseline. The 13 percent reduction that CBO attributed to the ACA explains more than half of that difference. Most of the remainder reflects a substantial but unexplained slowdown in the rate of growth in Medicare spending. CBO's analyses as well as studies conducted by other researchers have shown that Medicare spending began to slow before the enactment of the ACA—and before the 2007–2009 recession. CBO found that the recession's direct effects explained very little of that slowdown, which suggests that other factors were at work.<sup>12</sup>

*Other Health Care Spending.* Health care spending has grown more slowly in recent years than it has historically, both in absolute terms and compared with the pace of economic growth. Many analysts attribute at least a portion of the slowdown to the effects of the recent recession and slow recovery, but questions remain about the role of structural or other changes in the health care sector and about whether and how enactment of the ACA has encouraged those changes.

In addition to the fact that Medicare spending began to slow before enactment of the ACA, two other considerations suggest that the ACA's effects on health care spending may have been limited. First, the overall slowdown in the growth of spending occurred before most of the ACA's provisions had been fully implemented, so it is difficult to attribute much of the slowdown to specific provisions of the law. Second, the last time health care spending grew at roughly the same rate as the economy for an extended period was in the mid- to late 1990s—after an unsuccessful attempt to enact major health care legislation—which suggests that attention to the issue may be a more important factor than the enactment of legislation.

Nevertheless, it is difficult to dismiss the argument that implementation of the ACA's provisions has in some way been responsible for a push to control health care costs that has slowed growth in spending. But as one recent analysis concluded, “It is impossible to quantify how much the ACA has truly contributed to the reduced spending projections over time”—at least until more extensive data and analyses are available.<sup>13</sup> In light of that circumstance, CBO has not explicitly incorporated such an effect into its projections of federal spending on health care. Researchers continue to examine the issue, and CBO will update its analysis if research yields a more definitive conclusion.

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12. See Michael Levine and Melinda Buntin, *Why Has Growth in Spending for Fee-for-Service Medicare Slowed?* Working Paper 2013-06 (Congressional Budget Office, August 2013), [www.cbo.gov/publication/44513](http://www.cbo.gov/publication/44513); and Chapin White and Paul B. Ginsburg, “Slower Growth in Medicare Spending—Is This the New Normal?” *New England Journal of Medicine*, vol. 366, no. 12 (March 22, 2012), pp. 1073–1075, <http://dx.doi.org/10.1056/NEJMp1201853>.

13. See John Holahan and Stacey McMorrow, *The Widespread Slowdown in Health Spending Growth: Implications for Future Spending Projections and the Cost of the Affordable Care Act* (Robert Wood Johnson Foundation and Urban Institute, April 2015), p. 11, <http://tinyurl.com/q7j6kkc>.