



May 2, 2007

Honorable John M. Spratt Jr.
Chairman
Committee on the Budget
U.S. House of Representatives
Washington, D.C. 20515

Dear Mr. Chairman:

This letter responds to your request for information about how the Congressional Budget Office (CBO) reflects anticipated administrative actions in its baseline projections and how it estimates the budgetary impact of legislation directing or prohibiting such actions.

In preparing baselines and cost estimates, CBO necessarily and routinely must make assumptions or forecasts about a wide variety of future actions by the Administration—including possible regulations and many other types of actions. For example, CBO's baseline projections reflect assumptions about the timing and extent of oil and gas leasing on the Outer Continental Shelf; payment rates and eligibility requirements for various agriculture programs; the tax rates charged to finance the Universal Service Fund; the timing and structure of auctions of licenses to use portions of the electromagnetic spectrum; the issuance of rules to clarify or limit permissible activities in the Medicaid program; and the setting of prescription drug copayments in the Tricare for Life program of the Defense Department. In those types of cases, it is often not possible to avoid making some forecast or assumption about the Administration's actions.

In preparing budget projections, CBO makes its best judgment about what actions are likely to occur, taking into account current law, public statements and documents, information accompanying the President's budget proposals, previous actions by the Administration, informal communication with agency staff, the nature of the considerations that are likely to bear on the Administration's decisions, and other relevant factors.

The amount of information available varies greatly. When preparing a baseline that will reflect laws already enacted, CBO may be able to use preliminary versions of regulations or public announcements of agencies' intentions. When preparing an estimate for proposed legislation, CBO's best (or only) source of information may be informal judgments of an agency's staff. In each case, CBO weighs the information from various sources.

If it is clear, under current law, that an action will take place and what that action will be, CBO reflects that action in its baseline. For example, CBO's recent baseline projections for the Conservation Reserve Program (CRP) assumed that current participants would be allowed to reenroll when their contracts expire; since those projections were prepared, the Department of Agriculture (USDA) has, in fact, announced a policy finalizing the details of such reenrollments.

In contrast, if it appears unlikely that an action will take place or that it will have any significant budgetary effect, CBO does not incorporate that action in its baseline. For example, USDA was also considering permitting CRP contract holders to withdraw from their contracts without penalty. CBO concluded that was not a likely outcome and did not assume such a policy change in its baseline projection. The department has now indefinitely delayed a decision on that policy.

In some cases, it is unclear whether there will be an action or what it will be. In such cases, CBO may assign a probability to a specific action or choose a midpoint assumption among a range of possible actions in order to prepare its baseline projections. Such probabilities reflect both the likelihood of an action being taken and the likelihood that it will have the full potential effect. CBO may also have to make an assumption about the timing of such an action.

In general, the values of the probabilities used are limited. Typically, if the situation is quite uncertain, CBO will reduce the potential effect of a possible action by 50 percent. That adjustment would be equivalent to assuming that an action will occur and that it will have half the maximum possible effect, or that there is a 50 percent chance that an action having the full effect will take place and a 50 percent chance of no action or of an action having no budgetary effect. CBO's current baseline, for example, incorporates a 50 percent

adjustment to reflect uncertainty as to whether the Centers for Medicare & Medicaid Services will issue regulations to limit states' ability to use intergovernmental transfers to help fund their share of Medicaid spending and, if so, what those regulations might specify. (The agency has published proposed regulations in the *Federal Register*.) In rare cases, CBO assigns a lower probability to allow for some minor impact or a small likelihood of action.

As a result of those practices, which are essential to the preparation of any baseline projections, legislation mandating an action that could be taken administratively would have a budgetary impact unless that action—in its entirety—was assumed in the baseline to occur. Legislation barring a possible administrative action would have a budgetary impact unless that action was assumed in the baseline not to occur.

In either case, once a final regulation is issued or other final action is taken, that final action becomes the basis for scoring legislation, regardless of what was originally assumed for the baseline projections. In other words, CBO estimates the effects of legislation relative to a baseline that is updated to reflect new administrative actions.

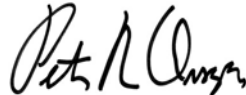
Although CBO's judgments about the likelihood of particular administrative actions may change from time to time, the agency has followed those general procedures for many years. In the past several years, CBO may have encountered more situations in which it has chosen to use a probability other than 100 percent or zero than in some previous periods; those situations do not occur frequently, however.

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I hope this description of CBO's procedures is helpful to you. If you would like any further information on this subject, I would be happy to provide it. The CBO staff contact is Robert Sunshine, Assistant Director for Budget Analysis.

Sincerely,

A handwritten signature in black ink, appearing to read "Peter R. Orszag". The signature is fluid and cursive, with the first name "Peter" and last name "Orszag" clearly distinguishable.

Peter R. Orszag
Director

cc: Honorable Paul Ryan
Ranking Member

Honorable Kent Conrad
Chairman
Senate Committee on the Budget

Honorable Judd Gregg
Ranking Member