S. HRG. 104-2

NOMINATION OF ROBERT E. RUBIN

HEARING

BEFORE THE

COMMITTEE ON FINANCE
UNITED STATES SENATE

ONE HUNDRED FOURTH CONGRESS

FIRST SESSION

ON THE

NOMINATION OF

ROBERT E. RUBIN, TO BE SECRETARY OF THE TREASURY

JANUARY 10, 1995

Printed for the use of the Committee on Finance

U.S. GOVERNMENT PRINTING OFFICE

88-546cc WASHINGTON : 1995

For sale by the U.S. Government Printing Office
Superintendent of Documents, Congressional Sales Office, Washington, DC 20402
ISBN 0-16-047536-8

S361-55

CONTENTS

OPENING STATEMENTS

ADMINISTRATION NOMINEE

ALPHABETICAL LISTING AND APPENDIX MATERIAL SUBMITTED

NOMINATION OF ROBERT E. RUBIN, TO BE SECRETARY OF THE TREASURY

TUESDAY, JANUARY 10, 1995

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

The hearing was convened, pursuant to notice, at 9:45 a.m., in room SD–215, Dirksen Senate Office Building, Hon. Bob Packwood (chairman of the committee) presiding.

Also present: Senators Dole, Chafee, Hatch, Simpson, Pressler, D'Amato, Murkowski, Moynihan, Baucus, Bradley, Pryor, Breaux, Conrad, Graham, and Moseley-Braun.

OPENING STATEMENT OF HON. BOB PACKWOOD, A U.S. SENATOR FROM OREGON, CHAIRMAN, COMMITTEE ON FINANCE

The CHAIRMAN. Mr. Rubin, good morning. Have a seat. We got started a little bit quicker than I thought we would get started.

Mr. RUBIN. All right. I am here.

Mr. Chairman. I wonder, Mr. Rubin, while we are waiting, I believe you have got some family members with you. Would you care to introduce them while the other Senators are sitting down?

Mr. RUBIN. I would be delighted to, Mr. Chairman. My wife, Judy Rubin.

The CHAIRMAN. Welcome, Judy.

Mrs. RUBIN. Thank you.

Mr. RUBIN. My son, Philip Rubin.

The CHAIRMAN. Philip.

Mr. RUBIN. My other son, Jamie Rubin, could not be here, but his wife, Gretchen Kraft-Rubin.

The CHAIRMAN. Hello, Gretchen. Glad you could be with us this morning.

Senators, are you ready? Senator Moynihan.

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

Senator MOYNIHAN. Yes, Mr. Chairman. May I just take the opportunity to begin by introducing to the Finance Committee one of the most distinguished members of the present administration, one of the most distinguished financial personages and civic leaders in the State of New York for the last generation.

Mr. Rubin, as you know, is the head, Assistant to the President, Council for Economic Policy and head of the newly-created National Economic Council, of which he is the chair. I think the statistics are clear, he has presided in 2 years over the largest job creation expansion in recent memory. Am I right that in 1994 we created 3.5 million jobs in our country?

Few economic advisers to few Presidents in the last century have been able, with the exception of war time periods, to oversee such an expansion. He has done this with unobtrusive, and obviously very fair and effective advice.

He is a man of great experience, great achievement. He has been the chief partner in Goldman Sachs, he has been a member of the board of directors of the New York Stock Exchange, and of the board of trustees of the Carnegie Corporation and Mt. Sinai Hospital in New York.

He is an accomplished private entrepreneur and public citizen, and I wholeheartedly recommend him to the committee, as will my colleague and dear friend, Senator D'Amato, and his old high school classmate, as we learn, Senator Graham.

The CHAIRMAN. I noticed that Mr. Rubin went to school in Miami, but I did not realize he had gone to school with Senator Graham.

Senator D'Amato?

OPENING STATEMENT OF HON. ALFONSE D'AMATO, A U.S. SENATOR FROM NEW YORK

Senator D'AMATO. Mr. Chairman, indeed, I am pleased to join with my distinguished senior colleague and former chairman of this committee, Senator Moynihan, in recommending to this committee Bob Rubin.

He brings an impressive background; impressive in terms of education, in terms of public service, not only here on the national level working for the President and people of this country, but also in the State of New York. He has served on just about every major committee and commission, and I might add, without compensation. Mr. Rubin comes before this committee with an impressive background.

I certainly recommend him with great pride to this committee. I join with Senator Moynihan. I think the President has chosen wisely.

The CHAIRMAN. Senator Graham.

OPENING STATEMENT OF HON. BOB GRAHAM, A U.S. SENATOR FROM FLORIDA

Senator GRAHAM. Thank you, Mr. Chairman. First, I want to express my appreciation of the opportunity to serve on this committee, and that my first duty as a member of the committee is to sit at this side of the witness table to sponsor my good friend, Bob Rubin.

Florida has had a long tradition of New Yorkers moving to our State. Bob represents our contribution to that deficit by sending him, on a temporary basis, north. We assume that he will eventually return to his roots.

It is not quite correct that we were classmates; we actually went to competing high schools. Bob went to Miami Beach Senior High School, I went to Miami Senior High School. And we competed with each other on our respective debate teams, not, I might say, to my benefit in that competition. Much has been said about Bob's professional accomplishments and his many areas of service. I would like to just supplement what Senator Moynihan and Senator D'Amato have said by some comments about Bob Rubin's special personality.

In my opinion, he defines a quality which is very valuable for anyone in this business, and that is a non-arrogant self-confidence. He knows who he is, he understands his core values, but he is also open to new ideas and to persuasion. He has used that quality with great skill in his responsibilities to date. He will, I suspect, have an even greater opportunity to use that quality in his new position.

I am very proud that he has been nominated by the President, and urge a speedy confirmation by the Senate. Thank you, Mr. Chairman.

The CHAIRMAN. Gentlemen, thank you very much.

Mr. Rubin?

STATEMENT OF ROBERT E. RUBIN, NOMINEE FOR SECRETARY OF THE TREASURY

Mr. RUBIN. Mr. Chairman and members of the committee, I greatly appreciate the opportunity to appear before you today, and I particularly appreciate your scheduling this hearing so expeditiously after the beginning of the 104th Congress.

I would like to thank my two home State Senators from New York, Senator Moynihan and Senator D'Amato, for introducing me and for their kind words, words which I have a feeling might very substantially exceed the reality that is before you. I would like to thank Senator Graham from Florida, where I grew up, for his very kind introduction.

I would also like to express my great respect for your long-time member and former Chairman, my friend of many years and colleague of the last 2 years, Secretary Lloyd Bentsen. He provided our administration and our economic team with experience, good judgment, consistent support for the spirit of teamwork, and wide-based experience in the areas that we were involved in. I look forward to his advice and guidance in the time to come.

For the past 2 years, I have served in the White House as the Assistant to the President for Economic Policy and Coordinator of the National Economic Council, where a truly outstanding group of cabinet members and White House officials have worked together on the economic issues of the Nation.

Before that, I worked for 26 years at a major international financial institution headquartered in New York where I had responsibility at various times for trading activities in equities, debt, foreign exchange, commodities, oil and derivatives, and various investment banking responsibilities both here and abroad.

I greatly welcomed the opportunity to join the Clinton Administration because I believed that this country was at a true economic crossroads and that, with all of our natural advantages, our economic future could be robust, but only, only, if we faced and dealt with the many problems and issues before us in a rapidly changing, global economy.

Conversely, I felt that if we did not deal with the economic problems before us, our prospects could be mediocre for as far into the future as the eye could see. I strongly identify with the President's broad-based, comprehensive economic strategy to get this country back on the right track, both now with solid growth and low inflation, and for the long term.

That strategy has been consistent from the very beginning of this administration down to the very present moment. It consists of: deficit reduction, education, training, programs for economically depressed areas, and other public investments critical to future productivity, targeted tax reduction, reforming and reducing government and government regulations, health care and welfare reform, and opening markets.

Through this strategy, our country, over time, can achieve fiscal order, strong productivity increases, and open markets which, in turn, will lead to healthy, long-term economic growth with low inflation and, very importantly, will give every American the opportunity to share in that economic growth.

Much has been accomplished within this framework in the past 2 years, often with bipartisan support. But much remains to be done at this critical juncture if our country is to prosper both now and for the long run.

Thus, in my opinion, Mr. Chairman, it is crucial that the administration and Congress work together effectively as we go forward. It is worth noting in this regard that this committee, in particular, has had major accomplishments on a bipartisan basis, including NAFTA and GATT.

Mr. Chairman, I am pragmatic and I believe that differences can usually be resolved—not always, but usually—by being straightforward and focusing on substance. If confirmed, I will work with each member of this committee and with the whole of Congress in exactly that spirit.

I also believe that there are no easy answers to the significant issues of economic policy and that difficult trade-offs are almost always involved.

As we face the likely legislative agenda for the next 2 years, I would like to suggest a few guiding principles.

Number one, Maintaining Fiscal Discipline. Tax cuts or spending programs must be paid for and we must sustain our efforts to continue reducing the deficit.

Promoting Productivity. We must endeavor to increase our National savings rate, and, within the discipline of deficit reduction, we need to continue to reorder the Federal budget to emphasize education, which had strong bipartisan support in the last Congress, training programs for economically depressed areas, and other essential public investments.

These investments in people are also key to equipping all Americans with the tools to participate in the economic growth of this country and to reverse the greatly increased and corrosive inequality that has developed over the last 20 years.

Number three, Supporting International Cooperation. In the new global economy we need to open markets, we need to sensibly but effectively regulate the vast international financial markets that so greatly affect all of our economies, and we need to help the developing and transitional economies.

Number four, Modernizing Financial Markets. We can make American financial markets, already the most efficient and most effective in the world, even more competitive and more efficient through modernizing regulatory structures and regulations. But the issues are very complex and competing considerations must be weighed carefully and thoughtfully.

Finally, if confirmed, I would endeavor to carry forward the United States Treasury's long and proud history of professional excellence and professional integrity which I have admired from the vantage points of both Wall Street and the White House for so many years.

Treasury has been and should continue to be a reliable and trusted resource for members of Congress and the general public. I also want to emphasize my commitment to Treasury's important law enforcement functions.

In conclusion, Mr. Chairman, I would like to thank you again for bringing me before this committee so promptly. I hope my comments have been useful.

Now I would be pleased to respond to any questions you might have.

The CHAIRMAN. Mr. Rubin, thank you. If I might just read the early-bird list so that the members will know where they are. I arrived here first today, then Senators Bradley, Moynihan, Graham, Moseley-Braun, Pressler, Breaux, Pryor, Baucus, Murkowski, D'Amato, Hatch, Chafee and Simpson. Did you hear where you are, John, on that list? The reason I say that is when I sat over there John was always the one that was asking me, ask the Chairman where I am on the list. Where am I on the list?

The questions I am going to ask—and Mark, hold me to my 5 minutes—are not in any way to indicate what my tax philosophy may be. I think it is reasonably well-known to the members. But the questions are not premised on a conclusion I want to reach necessarily.

One, are you convinced that if we increase the national savings rate it will increase productivity? And the reason I ask that is I have a memo from the Library of Congress that says, no. I am not sure I agree with it, but I have a memo to the other effect.

Mr. RUBIN. Mr. Chairman, both the President and I think that savings are essential to future productivity, and future productivity is where the future of this economy lies. There is a view amongst economists, and I think much less so amongst market participants, that with the globalization of the international financial markets, it may well be that the savings rate has declined in importance because capital moves across borders relatively easily and, therefore, the demand in this country can be met from savings wherever they may take place.

I would suggest to you, Mr. Chairman, that those global efficiencies are vastly overstated. In the very short end of the maturity spectrum for fixed-income securities, I think it is probably true, we have a true global financial market, therefore, domestic savings are probably relatively less important.

But, as you get out into longer maturity debt securities, debt securities for corporate issuers, and even more, equity issuers, I think that capital tends to be very sticky in the country in which it is raised as a result of savings. So, I think that cost of capital is very much affected by the savings rate, and the savings rate is very important to the future growth of this country.

The CHAIRMAN. Without asking whether you agree or disagree with it, what is your interpretation of the term "supply side economics?"

Mr. RUBIN. Well, I think that is a concept that has had many different meanings, and I will suggest two, if I may. One, is that if you lower taxes you will get commensurate economic growth and ultimately the Treasury will have resources that exceed the resources that have been lost by virtue of the lowering of the taxes. In a sense, it is kind of a trickle down concept of economic growth.

I do think there is another concept of supply side which is not one ordinarily used, but I think is, at least worth considering. If we can equip the American workers with education and training that will enable them to compete competitively on a global basis, then the United States can become the location of choice for these vast international businesses and we can greatly increase employment and standards of living in this country.

So, I think there is a concept of supply side economics that focuses on the skills and education of our people which, in my judgment at least, makes a lot of sense.

The CHAIRMAN. I want to read you a quote from the Joint Tax Committee. It is a letter that they sent to me in October. And the letter has been misused—not by them, not by me—and I just want to clarify something. I asked them if they could tell me how much money we could raise if we had a 100 percent rate of taxation on incomes above $100,000. They said, no, they could not do that. They could tell me how much untaxed income there was above certain levels, but they had never run a model of 100 percent level of taxation.

But in their letter they have this statement, "At a proposed tax rate of 100 percent, these effects would be extraordinary. If the 100 percent tax rate were to be in effect for a substantial period of time so that taxpayers would have no rational hope of avoiding or evading the 100 percent tax in the out years by deferring income to lower rate years or using other tax avoidance or deferral plans, in our judgment there would be a substantial reduction in income producing activity in the economy and a significant reduction in tax receipts to the Federal Government." Would you agree with that?

Mr. RUBIN. I would agree with that, Mr. Chairman. But I suspect one could take that argument to other propositions with which I would not agree.

The CHAIRMAN. I am not quite sure what that means.

Mr. RUBIN. Well, I am just anticipating where you might or might not be going next.

The CHAIRMAN. Well, all right. Yes. You can see where I am going with it. And this was on incomes of over $100,000. And this is theoretical. I understand that. If we lowered the tax rate from 100 percent to 90 percent, we might collect some more money than we would collect at 100 percent. That would be a supply side theory, would it not?

Mr. RUBIN. That is correct.

The CHAIRMAN. And maybe we might collect more money at 80 percent than 90 percent.

Mr. RUBIN. There will come a point though where I think you cross the line.

The CHAIRMAN. That is correct.

Mr. RUBIN. That is why I said I would not necessarily agree with this argument.

The CHAIRMAN. Well, you agree with the argument, you do not agree with the point at which we might cross. At zero we would not collect much money either, and at 100 percent we would not collect much. There is a magic point, whether that is 30 percent, 40 percent, 50 percent. I am not going to argue it here. There is some point.

Senator MOYNIHAN. 28 percent.

The CHAIRMAN. 28 percent, Senator Moynihan says. [Laughter.] And I thought we had the point one time.

Senator BRADLEY. 28 percent.

The CHAIRMAN. But here is the only point I would make on this, and I would hope, therefore, we do not get into it. If you had this theoretical 100 percent rate at over $100,000 and we cut it to 90 percent, I can picture demagogues who would say, that only benefits the rich. Nobody else is going to be benefitted, they're not paying the 100 percent rate.

That should not make any difference if it actually raised money. And we will get into this later with the capital gains issue, and we know the differences. The Treasury Department formally estimated, that President Bush's capital gains raised revenues. If we honestly thought a capital gains proposal would make money, even if the principal beneficiaries of it were the rich, we should not complain about it if it produces more money.

Mr. RUBIN. Senator, could I respond to that?

The CHAIRMAN. Yes.

Mr. RUBIN. In two respects. Number one, on the hypothetical which you set up, the point that you were then trying to make, there were a lot of debates at the time that we proposed the tax increase on the top 1.2 percent of Americans in order to get the powerful deficit reduction program that we put in place in 1993.

And the argument we made was that you could increase the tax rate to 39.6 percent and that would not deter activity. Some very distinguished economists wrote articles to the contrary; I think they were just basically wrong. I have dealt a lot with high compensation individuals and, wherever the point on that spectrum is, it is well above the rate at which we took the income tax rate, in my opinion.

Second, as to the capital gains tax discussion which I suspect we may have at somewhat greater length than this hearing, as you have said, one criterion, but only one criterion, is tax fairness.

And then there are a whole bunch of other criteria, and you take them altogether and, based on all those criteria, you make a judgment whether a tax proposal makes sense or not, which would be our view, and I suspect from what you said, it would be your view as well.

The CHAIRMAN. Thank you very much.

Senator Moynihan?

Senator MOYNIHAN. Mr. Chairman, I think Senator Bradley——

Senator BRADLEY. Oh, no, no, no.

The CHAIRMAN. Pardon me. You are right. Senator Bradley is next. My mistake. Go ahead, Bill.

Senator BRADLEY. Welcome to the committee. I am very pleased to see you, Mr. Rubin. It is a great pleasure. I am sorry I was not at the table to also introduce you. I thought it would be appropriate if the whole committee was at the table to introduce you to the one member of the committee that would still be sitting on the panel.

Mr. RUBIN. Senator, if you had lower tax rates in New Jersey and I would move there, then you might have been at the table. [Laughter.]

Senator BRADLEY. Now, let me ask you, on the issue of savings, we have a lot of suggestions for tax vehicles to increase private savings. One of them, for example, is the backloaded IRA, others are straight IRAs, 401(k)s, varieties of other savings. Each of those cost money. In other words, they increase the deficit.

The CHAIRMAN. Senator Bradley, I wonder if I might do this. I have talked with every member, or my staff has. There is no objection to our confirming today Mr. Rubin, and we have a quorum. I would like to just call now, if I could, for a vote and we will go on with our questions for as long as we want. The reason I ask this is that every now and then, somebody raises the issue on the floor about whether you had a quorum. We have one now.

Senator BRADLEY. Mr. Rubin, you are lucky that you were confirmed prior to this question. [Laughter.]

Mr. RUBIN. I presume the confirmation is revocable, Senator.

Senator BRADLEY. So the point is that these vehicles also lose money in terms of increasing the budget deficit. What impact do you think that they will have on the overall national savings rate? Because if you increase private savings marginally and decrease public savings by increasing the deficit, you have decreased overall savings. So how would you suggest we look at these various proposals to increase private savings?

Mr. RUBIN. Senator, your analytic framework is, as you know, exactly right. When the President first took office and a whole bunch of us talked about the various things that he felt needed to be done, one of the emphases that he had was on increasing savings.

And he made the observation at the time, which seems to me is absolutely right, that the quickest way to get the savings rate up was to get the deficit down. And, as you know, that was a priority in 1993 and, in fact, was accomplished in a rather substantial fashion.

When you go beyond that, when you look at individual proposals, Senator, the IRA, as you know, is a proposal that people have talked about for a long time. Some people feel that all it does is shelter savings that would have taken place anyway, in which case it has very little marginal impact.

My own view is that the proposal that the President proposed in the Middle Class Bill of Rights is an IRA proposal that has a real chance of increasing savings. It is, as you know, frontloaded or backloaded; you can take a choice. You can either put the money in and deduct it when you put it in, or you can not deduct it when you put it in and then you get the proceeds out tax-free.

I think, even more importantly, you can withdraw the money as you go along for various purposes—education, various medical purposes—so it is not simply putting money in to save for some distant retirement date, but really is a very flexible savings vehicle.

My instinct is to think that there is a real chance this thing could take hold, particularly if financial institutions decide to advertise it because they think they can build a real business. And I think we may have found a vehicle that really helps increase savings rates in this country.

Senator BRADLEY. Overall savings rates?

Mr. RUBIN. Yes, the overall national savings rate, by which I mean that the savings increase will substantially exceed the increase in the deficit, or, alternatively, the cost to the Federal Government that is involved in the IRA.

Senator BRADLEY. Another issue we will debate that has already come up is capital gains. And there are various approaches to it, one of which is indexing the basis of capital gains so as not to tax, whatever the rate might be, the inflation gain, but, instead, tax the real gain. Do you believe that indexing the basis of capital gains is responsible without also indexing the deductions, in particular, interest deductions?

Mr. RUBIN. Senator, to start with—and I guess this goes back to some comments that Chairman Packwood also made—I believe, and much more importantly, the President believes, that investment and savings and, thereby, productivity, are critical to the economic future of this country.

I think the debate really only becomes one of, what types of measures should be taken toward those ends. And, as you and I discussed a moment ago, I think the IRA is something we clearly should do. I think that indexing capital gains is an issue that we need to look at more thoroughly.

I think we need to look at it against the following criteria: does it increase economic growth, that is to say, jobs and standards of living; what effect does it have on fairness; and is it fully paid for? Because the President, at least, feels that we must absolutely not have any tax cut that is not fully paid for in a real and serious fashion.

Indexing is extremely complicated to apply to the vast variety of assets that it might apply to, and I do not have a ready answer to your question. We have discussed this recently, I might add, with some of the Treasury officials. Their suggestion had been that any particular indexing proposal brought to us we would be looked at in a careful and thorough way against the criteria I have just mentioned.

Senator BRADLEY. If you do not index the deductions, you end up with much smaller gain and much larger deductions and you push this whole process much more in the direction of various tax shelters that can be leveraged in ways that do not lead to the most efficient allocation of capital.

Mr. RUBIN. Without making any prejudging comment on capital gains, because I do not think I should be in a position of prejudging capital——

Senator BRADLEY. Right.

Mr. RUBIN [continuing]. One of the issues that gets involved in the debate on capital gains is always this issue of the potential for converging ordinary income to capital gains and, thereby, tax sheltering, and indexing, as you say, would lend itself to that.

Senator BRADLEY. You have responsibility for the administration's exchange rate policy in Treasury. I was wondering whether you think that the approach that has been taken to Japan, the depreciation of the dollar versus the yen the last couple of years, has proved productive.

Mr. RUBIN. Senator, let me discuss the premise of your question, because I think the issue lies in the premise, not in the question. This country I believe in, Senator Bentsen strongly stated that he believed in, this administrative believes, that a strong dollar is very much in this Nation's economic interests, both now and for the long term.

We have never, never used the exchange rate as an instrument of economic policy. Exchange rates over time are going to reflect fundamentals, Senator, and I believe the fundamentals in this country are very strong and, as a consequence, I think we will have a strong dollar over time, but as a reflection of the fundamentals.

The CHAIRMAN. Senator Moynihan.

Senator MOYNIHAN. Thank you, Mr. Chairman.

Mr. Rubin, as you know, in your last passage in your testimony you spoke about the law enforcement functions of the Treasury, which is a refreshing statement, as we very rarely hear about these from Secretaries of the Treasury. But they are important. I mean, we are a country hugely concerned with matters of crime and handguns, and the mortality and morbidity associated with them.

Over the last decade, the Congress has begun to legislate with respect to certain rounds of ammunition. There is a simple fact, we have about a two century supply of handguns and a 3-year supply of bullets. Guns do not kill people, bullets do.

Since the Revenue Act of 1918, the Treasury Department has had the responsibility to license the manufacture of ammunition and to tax it. Increasingly, we have been wondering, we have never heard from the Treasury that it has any interest in this responsibility.

There was a little event over the turn of the year when it was reported—and I just read from the New York Times—"Lethal New Ammunition Penetrates a Federal Ban." Down in Huntsville, a manufacturer said he had produced a bullet which breaks into thousands of razor-like fragments when it strikes human flesh. The fragments become lethal shrapnel that is "hurled into vital organs, lungs, circulatory components, the heart, and other tissues. Death is nearly instantaneous. The beauty behind it," the manufacturer went on to say, "is that it makes an incredible wound." These are called Black Rhinos. One was armor piercing, the other had this quality.

Then a Treasury official said, there is nothing illegal under Federal law about such ammunition, even though in 1899 we signed the Hague Convention, a treaty, which is the supreme law of the land, again, in 1907, banning precisely such bullets, those dum-dums, in the armory outside of Calcutta where they were first produced.

The Washington Post responded saying, "From the blood-chilling claims being made about these bullets, there is nothing here that America can condone." Metropolitan chief police Fred Thomas said, "Congress should do whatever it takes quickly to ban the bullets."

Then on Sunday in the Washington Post we read, "Federal regulators have decided to approve the sale of the Rhino fragmenting bullet."

Mr. Tom Hill, in this case, says, "According to our tests, it's no different from any other hollow-point bullets on the market." Well, a hollow-point round is a violation of the Hague Convention. The United States military will not allow them. The regulation is so precise.

How can the Treasury be so insensitive to this? In 18 years on this committee I have never heard a word from the Treasury—I do not think you have, Mr. Chairman—about this role in law enforcement of controlling the supply of ammunition which only kills police officers, kills human beings. It has nothing to do with sport. Does that not arouse some concern? I am sure it does.

Could you tell us what you might propose, and what on earth was in the mind of the man speaking, not on your behalf but on behalf of the Treasury, who said it is like any other hollow bullet. It violates international law, but it is okay on the streets of the United States. Now, he did not say the latter, but I did.

Mr. RUBIN. No, I understand, Senator. You have had a long history, Senator, of being concerned with the problems of urban America, particularly social disintegration and crime, a set of issues you know the President is also very much concerned with. And I think you very rightly raise the question of these types of ammunition.

I have read the same articles you did, actually. When I first saw them, I thought they were very concerning. I have since been briefed by people at Treasury, and I find that it is a rather complex situation. Their authority is rather limited, but, on the other hand, these are very serious issues.

I think I am right in saying this, but I will not absolutely attest to it, that the newspaper may have gotten that slightly wrong. I do not think that the bullet was approved, I believe it was tested. But we have very limited ability in Treasury, under current law, to deny a manufacturer the right to sell bullets unless it violates certain bans on certain types of bullets. And then there is a whole other set of interests, as you know, the interests of sports people and legitimate interests of people for self-defense.

So, when you put all that together, it is a rather complex interest, your very serious concerns, the interests of sports people, the interests of people for self-defense.

What I would like to do on this matter—because I, too, had a very serious and concerned response when I saw those articles, Senator, is, if confirmed, meet with the experts at Treasury, develop a thoughtful response to the questions that you are raising, and then come back and discuss them with you.

Senator MOYNIHAN. Good. Good. That is a very forthcoming response. It is an issue whose time has come. After 70 years, getting the Treasury Department interest, I would not say, is precipitous. Thank you very much, sir.

Mr. RUBIN. Well, you once told me, Senator, that every action in government takes 35 years, so this has taken twice your rule.

Senator MOYNIHAN. Yes.

The CHAIRMAN. I tried Senator Moynihan's theory once on an audience on the gun registration/gun ban issue and I said, you know, guns last 100–200 years, but no one keeps 100 years' supply of ammunition. And a guy stood up and said, there is in my basement.

Senator BRADLEY. Was this in eastern Oregon?

The CHAIRMAN. It was in eastern Oregon.

Senator Graham?

Senator GRAHAM. Thank you, Mr. Chairman. First, Mr. Rubin, I want to commend you on a very excellent opening statement that outlined the principles upon which the administration and the Treasury Department, under your leadership, will be guided.

I would like to focus on the third principle, which was supporting international cooperation. You mentioned that two of the successes of the administration have been the passage of the NAFTA and the GATT. I would like your ideas as to where you see, over the next period, the administration is attempting to lead the Nation and the world in terms of international cooperation.

Mr. RUBIN. Senator, this President came into office with a deeply held view as to what he felt this Nation needed to do, not only to get on the right track now economically—I mentioned this in my statement—but to position itself for the long-term. And productivity was obviously one of the high priorities, but another was opening markets around the world.

I might add, parenthetically, that for the most part these markets have higher barriers than we do, so that when you open those markets and we reach peripassu in terms of openness, it is much to our benefit because their barriers are higher, as well as for the traditional reasons of comparative advantage.

As we go forward, and the President very much wants to go forward in this area, we have the possibility of a free trade agreement with Chile, as you know, because that has been publicly announced.

APEC, Asia Pacific Economic Cooperation, is an organization that has enabled this country to take an important role in working with the nations of the Pacific Rim to open up the Pacific Rim nations to trade with the United States. And, as you know, the President was the first leader to suggest that that be turned into an annual leader's meeting, and I think really has re-energized APEC.

So, I think you will see a lot of activity in Asia in the early states, Senator, to deal very practically with the problems in trade, different contract provisions, and contract laws in different countries, things of that sort but ultimately leading toward free trade in the region.

Latin America offers us enormous opportunities. NAFTA was a first step. We clearly want to go much further in that respect and we have natural advantages in Latin America because of our location.

We have trade differences with Japan, and those must be faced in a forthright fashion. The second largest economy of the world cannot have substantially different access to its markets and the other major economies without hurting the free trade system of the world.

It is very much in the interests of Japan and this country for those problems to be resolved. And the President, I really think, for the first time in a long time, has been willing to face those issues in a serious and thoughtful fashion, and we are making progress.

I think that would be a brief summary, Senator, of the broader vision with respect to where the free trade initiative should go, not only over the next few years, but really over the next decade or so.

Senator GRAHAM. If I could focus on the particular issue of Latin America, Latin America seems to be organizing itself into a series of sub-regional groups, such as the Merkasur group at the southern cone; at the north is NAFTA, in which we and Canada are also participants.

Do you have a sense of how we will move towards closer economic integration within the hemisphere within the context of the currently emerging sub-regional groups?

Mr. RUBIN. Senator, I think you have made exactly the right point. And this is true, by the way, in Asia as well. It is very much in the interest of this country to be at the center of the world's trading systems.

And in Asia you have at times something of a tendency toward regional trading blocks of which we were not a part. So, it is in our interest, as a consequence, to nurture APEC, which gives us the opportunity to be a central part of what would then be the major trading group in Asia.

Similarly, in Latin America, it is our view—and this really was the purpose of the Miami Summit that was held last month—that we need to work throughout Latin America so that Latin America as a whole becomes the trade area rather than having subgroups of which we are not part. That is precisely what we are attempting to do in Latin America.

Senator GRAHAM. In the last few weeks there has been a lot of attention focused on Mexico and the potential ripple effect that that might have on the economic development of other nations in the hemisphere.

I would like your comments as to whether you see this situation in Mexico as being isolated to that country and episodic, or will it have a more pervasive impact throughout Latin America and the Caribbean?

Mr. RUBIN. Senator, I think that is a very complicated set of questions. I do not know that it lends itself to a very brief response. Mexico accomplished enormous reforms under President Salinas, and to some extent under his predecessor, in the area of privatization, opening markets, deregulation.

As a consequence, the country is in a far better position today than it was before to realize the very substantial economic potential that Mexico has. At the present time, it clearly is experiencing some difficulties. I think it is very much in our interest to support them as they work their way through those difficulties.

As you correctly observe, the difficulties that Mexico is currently having have started to affect foreign exchange markets with respect to certain other Latin American countries.

The potential for this country in Latin America is enormous and, therefore, it is enormously important that we work with Mexico and help them work themselves through this current difficulty, not only to help Mexico, but to make sure that that does not spill over and interfere with the realization of the very substantial potentials in Latin America for those countries and for us.

The CHAIRMAN. Senator Moseley-Braun.

88-546 O - 95 - 2

Senator MOSELEY-BRAUN. Thank you very much, Mr. Chairman. I would like at the outset to say how delighted I am to be here. A friend gave me an embroidered pillow for Christmas that said, "A Woman's Place is in the House and in the Senate." She has threatened to take it back and add, "And on the Finance Committee." So I am just delighted to be here.

To you, Mr. Rubin, I am delighted to see you again. Thank you very much for visiting with me earlier last week to discuss some of the issues pertaining to your confirmation.

I ran into a woman at the airport who just stopped me to talk about her own issues, and she was very concerned, as the owner and founder of a new business, about whether or not banks would be willing to lend to her. She needed about $5 million, and she talked about that mid-level of lending for start-up businesses.

I guess my first question to you would have to do with that kind of support for small- and medium-sized and new businesses. As Secretary of Treasury, what role, if any, will you engage in to promote investment and encourage lending to small and new businesses?

Mr. RUBIN. Senator, when the President first took office he posed the same question to me. And he said, what are the kinds of things that we can do to help get capital to that segment of the capital market where it goes least readily? I assume you are talking about a privately-held company.

Senator MOSELEY-BRAUN. Yes.

Mr. RUBIN. Privately-held smaller and medium-sized companies. And we have taken a number of steps. We proposed, and Congress enacted, a targeted capital gains tax reduction for smaller companies, and patient capital, which I think was a very good proposal, something we were very supportive of.

Sometime within the first few months of the first year of this Presidency, the Treasury announced what it called a "credit crunch initiative," which was aimed at reducing the regulatory pressure on banks and easing up lending in banks.

I know the Small Business Administration, under the exceedingly able leadership of Erskin Bowles, has taken a number of steps to cause the SBA to function more effectively, usefully, and usably, in response to the requests of small business.

CRA, Community Reinvestment Act, is designed for a particular purpose within that context, which is to make sure that economically depressed regions are not treated unfairly by lending institutions, to make sure that capital is available, on an economic basis, in those regions.

We also proposed, and Congress adopted, an expensing provision in 1993 which was designed to help small business buy capital equipment more readily.

And I guess most broadly, Senator, the deficit reduction program which lowered interest rates and the recovery—which, in my judgment, could not have happened without a deficit reduction program—probably is the biggest and most important help that we have been able to give to small business.

Having said that, and having recited the list of things that have come to mind—and there are probably others that do not come to mind at the moment—we would be very receptive to any proposals that you might have, because this is very much a focus that the President has.

Senator MOSELEY-BRAUN. Thank you. Chicago was very excited, as were other communities in Illinois, two or three weeks ago now with the announcement of the empowerment zone designation.

People are, again, excited about the opportunities, or at least the prospect and the potential for renewed investment in the inner cities, as well as rural communities that need that investment.

What opportunities, if any, do you see for coordination of the activities of the Treasury Department with the activities of other governmental units such as HUD, such as Department of Agriculture, which has a role, to stimulate economic development, again, in communities, both urban and rural, where that economic development is so needed?

Mr. RUBIN. Senator, I believe, and I know you very much believe, that the economically depressed areas of this Nation, in some measure, will determine the future of this country's economy for all of us. And if the country does not deal effectively with those areas, that will be an enormous burden or problem for the entire economy and, therefore, for all of us.

Before I came to this job, I had the opportunity to chair something called the Cuomo Commission. Governor Cuomo set up a commission to focus on precisely the question you are raising, which is, what could be done to improve the economic conditions of the economically depressed areas and bring the residents of the economically depressed areas into the economic mainstream?

If confirmed as Secretary of the Treasury, that is an area that I would very much like Treasury to get involved in with the other agencies of government that have a concern with and involvement in these areas. And, I might add, Treasury is already involved in a number of respects, including the design of these enterprise zones.

So, while I do not have any specific answer for you right now, Senator, it is something that I very much would like to focus on if confirmed as Secretary of Treasury.

Senator MOSELEY-BRAUN. Well, I expect you will be.

Finally, in your opening statement I was delighted to hear you refer to what you called essential public investments. I was reminded of the Chairman's remarks. When I first came in the room, you were talking about the debate around scoring and what goes into the scoring analysis.

Would you share with us any views you might have—and quickly, because my time is almost up—on the debate about the considerations that are appropriate to budget analysis, to the scoring debate?

Mr. RUBIN. Senator, when we first met with the President in Little Rock in early January, I believe it was, of 1993 before we came to Washington, we had the economic team around the table in the Governor's office.

We were putting together the beginnings of the first budget and he turned to Leon Panetta and he said, "Leon, I want credible numbers, I want real numbers, and I want to adhere to existing budget methodologies. I will have all the policy debates in the world with people, but I do not want anybody to ever doubt my numbers."

I believe that is a very good and sound principle. I think the dynamic scoring, which I assume is the issue you are referring to, although appealing on the surface, involves enormous conceptual problems and, if adopted, is a slippery slope which will lead to undermining the fiscal discipline which I think is essential to the economic future of this country.

The CHAIRMAN. Senator Pressler, and then Senator Pryor.

Senator PRESSLER. Thank you very much, Mr. Chairman, for the welcome to the committee.

Let me just say that I have returned from the South Dakota Governor's inauguration, where I talked with Governor Janklow and his staff.

One of the things that South Dakota is interested in is the establishment of a foreign trade zone and a U.S. Customs port of entry. My home State is currently the ninth fastest-growing exporter in the country. The establishment of a Customs port of entry is vital to the continued growth and competitiveness of over 300 South Dakotan firms heavily engaged in international trade.

The State of South Dakota is one of only two States in the country that does not benefit from a U.S. Customs port of entry under the jurisdiction of the Treasury. Will you be supportive of providing those same benefits to South Dakota, and in your role as Secretary of Treasury can you guarantee a speedy processing period for South Dakota's port of entry application?

Mr. RUBIN. Senator, when you were kind enough to see us—I went around and visited every member of this committee—you had raised this issue. Afterwards, I discussed it briefly with someone at Treasury. Although I do not have expertise in it, but it certainly sounded, based on what I have been told, as if there was enormous merit to the case that you were making. I will absolutely promise you this, that if confirmed I will get myself fully briefed and we will bring this to a resolution in an expeditious fashion.

Senator PRESSLER. Good. Thank you very much.

Let me ask you a question about your firm and your leadership at Goldman Sachs. Is there anything that this committee needs to know about any of its relationship with BCCI or any relationship with the current contract with Germany or BCCI? Is there anything that we need to know that would help us evaluate your candidacy for Secretary of the Treasury?

Mr. RUBIN. Senator, to the best of my knowledge, I do not believe that our firm ever had any business with BCCI, but I can have somebody check that and get back to you.

Senator PRESSLER. All right, if you could.

Mr. RUBIN. Or let me put it differently. If the firm did have any activity with BCCI, I am certainly not aware of it.

Senator PRESSLER. All right. Could you put in the record anything you can find on that matter?

Mr. RUBIN. I would be happy to do so.

Senator PRESSLER. And also on the current relationship with Germany, the contract that has been entered into with Goldman Sachs. You were not involved with that in any way.

Mr. RUBIN. This is the first time I have ever heard of it, so I guess that would be a fair comment, yes.

Senator PRESSLER. All right. Great. You can put anything in the record that you come up with on that.

[The information appears in the appendix.]

Senator PRESSLER. Let me ask a question about static versus dynamic reporting of things. Lately there has been a lot of talk concerning the issue of dynamic revenue estimating versus static revenue estimating.

Although I realize this is largely a Budget Committee issue, ultimately it will affect the decisions made by the Finance Committee as we analyze the budgetary impacts of upcoming tax cut or spending cut proposals. I understand that the administration favors static revenue estimating. What are your thoughts on this?

Mr. RUBIN. Well, Senator, as I said a moment ago, I think on the surface, dynamic scoring has a certain appeal. But I think that the more that you look at it the more troubling it becomes.

For one thing—and I have talked to a number of economists about this who are what I would call politically neutral, they have no particular axe to grind—I think that the kinds of estimates that you can make about the effects of GDP on policy measures are insufficiently reliable to want to base a budget upon.

I, therefore, consider it very troubling to think that we would have a Federal budget based on estimates that have been made of macroeconomic impact from various proposed policy measures.

Relatedly, and I think even more seriously, if you are willing to accept what I think is probably very substantially imprecise estimates that you can get, I think almost everything that comes before Congress can carry with it a powerful macroeconomic impact debate.

For example, I know that that is the argument very often used by proponents of capital gains, but I know people who will make, I think, an even more persuasive argument for child immunization. And certainly many advocates of education feel—which I happen to also feel—that the economic future of this country may depend on the public school system.

So, certainly then, education advocates can make a powerful dynamic scoring, macroeconomic impact case. By the time you are all finished, my fear, Senator, is that you have gone down the slippery slope I mentioned before and you have lost all budget discipline. That, I think, would be horrendous in terms of the economic future of this country.

Senator PRESSLER. I know that several Senators, including Senators Dole and Grassley, have been leaders on the Farm Investment and Loss Insurance Plan. Under this plan, as I understand it, and I am a co-sponsor of it, it would allow farmers to have an expanded IRA type of account so that—it is a very volatile industry, agriculture, the incomes going up and down—under certain conditions of low income years, farmers and ranchers would be able to draw out of this farm account. It would be an interest-bearing FDIC or FSLIC insured account, or other non-speculative IRA-type of investment fund and during the good years you would pay in. Taxes would be withheld until the funds were withdrawn and producers would be able to withdraw funds in those years where income drops below certain thresholds.

Do you support this concept to help reduce the risks associated with farming and ranching?

Mr. RUBIN. Senator, I am aware of the issue. And, as you very correctly say, farmers do experience vicissitudes in their incomes, although people in other areas do as well, but farmers certainly do based on climate, markets, and one thing or another.

I am aware of the issue, as I have just mentioned, but I am not expert in it. I think probably the best thing for me to do, if confirmed, would be to get briefed by the people at Treasury and then get back to you and work with you on this.

Senator PRESSLER. All right.

On the issue of tax simplification—am I over my time? I will submit my questions on tax simplification for the record.

The CHAIRMAN. I appreciate it very much.

[The questions appear in the appendix.]

The CHAIRMAN. I had indicated Senator Pryor is next. Senator Breaux has come back. Would you yield to Senator Dole for him to make just a quick statement?

Senator BREAUX. Yes.

Senator DOLE. Well, I just wanted to come over and indicate, as I indicated earlier, that I think the President made an outstanding choice. I knew it was going to be easy, but I did not know they would vote before the questions. I apologize for not being here. I wanted to vote aye, so put me down as voting for him.

Mr. RUBIN. Thank you, Senator.

Senator DOLE. It is a very important job. I have always considered Treasury Secretary one of the most important jobs in this city, and I know it is a challenge. We have had a lot of confidence in your predecessor—he was one of our colleagues, the Chairman of this committee—as we have had confidence in other Secretaries. But as I said at the outset, you are a man of honesty and integrity and I believe that to be a fact.

I think we will do the best we can to have you confirmed today so we can get this to the floor. We will try to waive any rules and bring it up today so that you can go to work. I know you are already working.

Mr. RUBIN. I was going to say, I do not know what I have been doing if I have not been working, Senator.

Senator DOLE [continuing]. But you can be working at the Treasury tomorrow.

Just an aside, a comment—yesterday morning I was privileged to speak to about 6,000 farmers in St. Louis, members of the American Farm Bureau Federation. They are not Wall Street types, they are not big business people.

They had seven items, seven goals. One is the capital gains rate reduction. We have got a lot of land locked up all across America in all of our States that could be sold if we could determine some way to reduce the tax.

We will be discussing dynamic scoring and capital gains rate reductions later on, but I wanted to make the point because I think the point is made too often on talk shows that only the rich will benefit. And I asked all these 6,000 farmers and their wives, "Maybe you are in that category?," but most of them are not.

So, I hope there is some way we can look at this, because I think there is support on both sides, not just one side, for some rational approach that would lower the cost of capital and do a lot of things that we would like to do. But the purpose of my statement is to welcome you and to say that we will certainly have our differences, from time to time, but we want to work with you wherever possible.

Mr. RUBIN. Mr. Leader, I thank you for your very kind comments. And, as I said in my opening statement, I look forward to working with you and with all the members of this committee, and to being as responsive as we possibly can to your interests and to your needs.

The CHAIRMAN. Senator Breaux.

Senator BREAUX. Thank you very much, Mr. Chairman. Thank you, Bob, for being with us. I am delighted also to support your confirmation, as the Majority Leader has indicated his support.

I have known you for a relatively long number of years, and my memory is, before you were in government service, that we always had forums and meetings and Bob Rubin used to always complain about how government was not working properly in Washington.

Sometimes it was pretty discouraging, as someone who was working in Washington, to hear his thoughts and his criticisms, legitimate as they might have been. But I think that, to your credit, you have done more than just criticize.

I think that is such a powerful statement about a businessman who has been very successful in the business community who has seen that government can be made to work better than it has been working, and to become engaged at a great personal sacrifice to yourself and your family to be part of the team in charge of fixing the problems.

It is very easy to be a critic, but it is so much more important to be involved in helping to fix those problems that we see. I congratulate you for making that sacrifice.

Let me ask you, if I may, just one question, sort of on a philosophical basis. But it is going to be very relevant, because we are going to be dealing with a suggestion that is in the Republican Contract with America that was proposed on the House side, and that deals with the treatment of Social Security income.

Under the current law, 50 percent of a retiree's Social Security benefits are treated as income and taxes must be paid on it if they are in the $25,000 category for individuals, or the $32,000 category for joint filers.

In 1993, Congress modified that and we said that for filers earning $34,000 for individuals and $44,000 for couples that are retired, they would have to include up to 85 percent of their Social Security benefits as income.

At that time, we were told, I remember, that that affected only about 13 percent of the Social Security recipients who had an average net worth of $1 million. Is that still the figures that we are looking at for that group of tax filers?

Mr. RUBIN. Senator, as you know, let me start it this way. The President is totally supportive of the Social Security system. The tax increase for the top 13 percent of Social Security recipients—and to the best of my knowledge that number is approximately correct—was designed to bring that Social Security benefit into line from a taxation perspective with what would obtain for private pension fund benefits.

Senator BREAUX. In fact, that was a recommendation, as I remember, from the Social Security Commission, that we should look at Social Security benefits, and treat them, similar to private pension plans.

Mr. RUBIN. Right. Now, there is some debate about that recommendation, I gather. But the view that we had at the time was that the deficit reduction was of overriding need to the country, number one. Number two, the President totally supported the Social Security system. Number three, that for that 13 percent of Social Security beneficiaries, it was not an unreasonable thing to bring them into peripassu position with private pension beneficiaries.

Senator BREAUX. My question then, Mr. Rubin, is this. The contract recommends that we do away with the 1983 provision. As I understand it, that provision raised about $15 billion over 5 years and goes into the Medicare trust fund. And, over a 10-year period, I think the amount that would be generated by that change was something like $48.5 billion.

My question is, if we repeal this provision, as the contract calls for, what does that do to the stability of the Medicare trust fund?

Mr. RUBIN. Well, as you correctly say, that money was designed to go into the Medicare trust fund, both because it contributed to deficit reduction and because it supported the Medicare trust fund, it seemed to us, and because it could be raised in a way that did not disadvantage the people that it applied to relative to private pension funds. It seemed to us to be a sensible thing to do in those circumstances. Conversely, if you unwind it, you undo everything that we tried to do in 1993. We do not support that provision for those very reasons.

It is part of a larger problem, though. The Contract with America has a whole range of proposed tax cuts, as you know. Every one of them has a cost. I think what you need to do is determine how those are going to be paid for, and then you can make a judgment whether the manner in which it is going to be paid for strikes you as being worth what it costs you to get the tax reductions.

And then, of course, you have to decide with respect to each tax reduction, what benefits does that have for our economy for creating jobs, for increasing standards of living, and what impact does it have on tax fairness?

Senator BREAUX. Well, I am sure we will have a lot of opportunities to get into more discussion about the merits of these various proposals. I thank you for your response and look forward to working with you.

Thank you, Mr. Chairman.

Mr. RUBIN. Thank you, Senator.

The CHAIRMAN. Senator Pryor.

Senator PRYOR. Yes, Mr. Chairman. I want to take a moment just to inform all of our committee members this morning, if I could, that this man before us this morning is a man who thinks big. I had the opportunity last week to have Mr. Rubin in my office.

And I said, Mr. Rubin, rather than talking to me—I am already convinced—I said, in the next room I have 17 of the top political science students from Arkansas universities. Please step in there and visit with them.

And I introduced Mr. Rubin, Mr. Chairman and colleagues. I said, ladies and gentlemen, you fine political science students, I want you to know that this man, if he is confirmed, his name is going to be on this dollar bill before long. They were very impressed. Mr. Rubin came back and said, my name will also be on the $100 bill. [Laughter.] So he thinks big, Mr. Chairman and colleagues.

Mr. RUBIN. Senator, we are all a function of our environments. [Laughter.]

Senator PRYOR. Well, we are proud that you are here before this committee.

Mr. Chairman, I want to say to you, congratulations on once again becoming Chairman of this committee. It has always been a pleasure to work with you and to welcome our new colleagues this morning on this great committee.

Let me say that we have done a pretty phenomenal thing. I say we, the country has, in the past 2 years in the creation of some 4-5 million private-sector jobs. I think this gets lost and I think people forget this, and it may be even unprecedented.

But I wonder if you would comment, sir, and if you would draw us a little profile of what kind of jobs have we created, why have these jobs been created, and how we in the Congress, and especially in this committee, can help foster the creation and perpetuate the creation of these private sector jobs?

Mr. RUBIN. When the President took office, the unemployment rate was approximately 7.7 percent. And, as you know, it is now approximately 5.6 percent. That is on a comparable basis, the revised basis, for determining unemployment.

The economy has actually created close to six million jobs in that period. We have had an economic growth rate substantially in excess of 3 percent, and inflation is still below 3 percent.

I think there were a number of factors going on in the economy that have contributed to that, including very much the success the private sector has had in making itself more competitive. But there is absolutely no question in my mind that this recovery would not, and could not have happened had it not been for the deficit reduction program the President proposed and this Congress adopted in 1993.

And, recognizing there will be ups and downs—trees do not grow to the sky and economies do not go in only one direction—so there will be vicissitudes. But, in order to remain on a healthy economic track for the long term, which is really the guts of what the President is focusing on in this whole economic arena, that, and making sure that all Americans have the opportunity to participate in that growth, I think we need to keep ourselves on the deficit reduction track, keep focusing on the deficit, things I was talking about before. I think we have to make sure that our people are equipped to compete in a global economy.

One of the things the President has said that I think is most impressive is that we cannot turn back on the global economy; it is the reality in which we are going to have to live. We cannot say, let us go backwards. Therefore, we have to equip our people with education and training. I am particularly concerned, and he is particularly concerned, about people in economically distressed areas. They must become part of mainstream economy.

I think, Senator, if we do those things and if we make government work better and we reduce the regulatory burden and we get welfare and health care reform, we do all the things that the President has talked about so much since he took office, then I think we will be doing the kinds of things in the public sector that will complement what the private sector is doing so well, which is making itself efficient, and we really can be the leading economy in the world for a long, long time to come. The prospect is there before us, but we have to do the right things and that is the great challenge in both the public and the private sectors.

Senator PRYOR. Good. Thank you, Mr. Rubin.

I think that is a very good sign in our general, overall economy. One of the troubling signs that I see, and something that I think that this committee and many members of this committee, I believe, are very desirous of working out, is that we are facing the fact today that only 30 percent of the employees of small businesses have any type of a pension retirement, any type of a private retirement fund that is built in that we hope would help to alleviate some of the pressures on Social Security in the out-years.

I wonder if you might comment on this, if you might give us any words of hope there, or will we find a cooperative spirit with the administration in working through this issue?

Mr. RUBIN. Senator, the President, as I think I mentioned a bit ago, is very much focused on the question of medium- and small-sized companies, because that is where so much of the growth in this country is taking place. He has also been focused on the issues of pension funds and, as you know, a significant pension fund reform bill was passed last year with bipartisan support. A lot of the accomplishments that have produced the growth that we have today have had bipartisan support.

The issue that you have raised is one of which I am cognizant. We would be happy to work with you or any member of the committee who have ideas that would be useful in terms of trying to increase retirement security, because that is what is really involved here, for people who work in small- and medium-sized businesses.

Senator PRYOR. Good. Thank you, Mr. Rubin.

Thank you, Mr. Chairman.

The CHAIRMAN. Senator Baucus.

Senator BAUCUS. Thank you very much, Mr. Chairman. Mr. Rubin, I congratulate you on your job. I have known you, not as long as Senator Graham and Senator Breaux, but in the short period that I have known you I have been very impressed with your intelligence, your integrity, and also one quality which is in very short supply in Washington, DC, and that is humility.

Your self-effacing sense of teamwork and getting the job and not trying to claim the credit for it, let the credit go to somebody else, knowing that if you do it is more likely that you are going to be effective. I very much compliment you on that very important quality.

Mr. RUBIN. Thank you.

Senator BAUCUS. On this committee, it is very tempting to get involved in large, abstract concepts, savings rates, trade deficits, exchange rates, and so forth. I am a bit struck over the last couple of years as to how much middle income Americans have really not been in on a lot of the benefits that many Americans have reaped. Our income distribution in this country, as you well know, is diverging. The rich are getting richer over the last, roughly, decade. The poor are not getting any poorer, really, because we have increases, the income tax credit, for example. But the middle income Americans, the large bulk of Americans, are not in on the deal. They are not getting wealthier. Sure, a lot more jobs are created, but, as you well know, those are low-income jobs in many respects. In real terms, middle income Americans find that their family incomes, after inflation, have not increased.

So what can you say to that mill worker, that truck driver, that housewife, that teller in a bank, the average middle income American who might be watching here on C-SPAN, or listening in on us, to reassure him or her that we are really thinking of them, if not primarily, at least, as much as we are when we talk about these grand, abstract concepts? I think that is really why we are here. It is, frankly, to serve people as well as to debate concepts.

So, what can you say to those middle income Americans who have very real anxieties and fears? There are financial anxieties, and also I think there are some physical anxieties, crime, moral anxieties, that is, where this country is going. But let us just focus now on the income, jobs.

What can you say to them that could reassure them, and what can you say to them to enable them in a not too distant period of time to reassure them that, hey, they are in on the deal here, too?

Mr. RUBIN. Senator, I think you have raised a profoundly important question, and it is one that I can assure you is very much on the President's mind, and has been from the day he first took office.

The first thing that had to be done for middle income Americans to begin to get an improvement in their average wage—and, as you say, real average wages for most Americans have been stuck for a long time, in fact, in many cases, have been declining—is we had to get this deficit under control because without it we could not have a sustained recovery.

And, without a sustained recovery, you are not going to be able to improve the incomes of middle income Americans, nor will you be able to position the country for long-term economic health.

With that program now well under way, although much more to be done, he has turned his focus—and actually even at the same time had begun to turn his focus—to the public investments that will enable Americans to compete in the rapidly changing global economy, the economy that we are all inevitably going to have to be part of, whether we like it or not.

In fact, as he has so often said, if we do the right things, the rapidly changing economy can be an economy of enormous opportunity for us. It is only if we do the wrong things that it becomes a threat to us. And, as a consequence, he has strongly advocated education programs, and I think you all passed something like six or seven programs in the last couple of years, training, focus on the economically depressed areas, things that we have already talked about. These are not short-term fixes, Senator.

The developments in the international economy and in technology that have had an effect on middle class incomes are not short-term phenomenon, and these problems will not be solved in the short-term. But they will be solved, and they can be solved if we do the right things now and continue to do them, and that is precisely what he is trying to do.

Finally, he has proposed what he calls his Middle Class Bill of Rights and, as you know, that is a group of three tax reductions. In a way, you can look at them two different ways.

All of them are designed to help the middle class and, to some extent, offset the income erosion that they have experienced, as you observed just a moment or two ago, and help them participate in the growing economy that we now have.

In addition, each one of them spurs investment by the individuals themselves in some way that is relevant to helping them be better prepared for the future economy and, therefore, be more productive and have higher incomes.

Senator BAUCUS. Well, I thank you for that. I think that is a good response. But I strongly urge you, everything you do as the Treasury Secretary is focused very much on that central question. I think if we do—I think you made this point earlier—we are going to be a lot better off as a country.

One final question. I see my time has expired, Mr. Chairman.

Mr. Rubin, how do you want to be remembered? What legacy do you want to leave?

Mr. RUBIN. Well, like Senator Pryor said, maybe I would like not to be remembered. Some people would rather be forgotten. But, no. That is a very good question, Senator, and not one that one can answer readily.

I guess my answer is, as I said, I identify very strongly with the President's economic strategy. I do believe that it is, in its totality, the kinds of things that we need to do if this country is going to be on the right track for the long term, and I would like to be remembered for having helped advance that agenda.

I would also like to be remembered, if possible, for raising the profile of the concept that I expressed in my opening statement, that there are no easy answers to the significant issues of economic policy. And if we are going to make good judgments, those good judgments are all going to be trade-offs.

And, while we are going to get benefits, we are also going to have costs, and recognize that we have to incur those costs. That is a kind of an intellectual honesty and integrity in the decision making process on economic issues which I think is absolutely critical if we are going to make the best decisions for the country.

Senator BAUCUS. Thank you. Good luck.

The CHAIRMAN. Senator D'Amato, then Senator Chafee.

Senator D'AMATO. Thank you, Mr. Chairman.

Mr. Rubin, Mr. Secretary to be, you and I have discussed in the past, and I would like to raise again the issue of capital gains tax cuts and share with you my philosophy.

If there is to be some arbitrary limit as it relates to what income or income limitation or what size of the transaction will take it outside of qualifying, it seems to me that a good part of the economic benefit, the job production and job creation that we would hope takes place as a result of a capital gains tax cut, would be lost. I do not know what your feeling on that is.

How do you justify, for example, limiting all parts of society taking part in this, if you place an arbitrary limit, for example, and said no one above $200,000 can benefit, would you not then necessarily restrict and keep substantial portions of the economy from participating in the perceived benefits?

If there are no benefits, it would seem to me, then we should not undertake it. If there are benefits, then those benefits just should not be arbitrarily curtailed to people who make between zero and $200,000, or whatever level we arrive at. This is arbitrary, I would say. That is why I used the word arbitrary. Whatever level it becomes arbitrary, you then diminish the economic impact.

How would you respond to that?

Mr. RUBIN. Senator, I would agree with you, that nobody should have any religion on the subject of capital gains tax cuts. In fact, I do not think people should have religion on any policy issues. I think they should try to figure out what criteria to apply and then apply them in a sensible fashion and try to make a balanced judgment as to what is best for this country.

In the area of capital gains tax reduction, I think implicit in your question, really, are the various criteria that we would put forth: 1) does it increase jobs; 2) does it increase standards of living; 3) how does it affect tax fairness; 4) as an absolute requisite, it must be paid for.

So, if you have a particular proposal—and if you do we would be happy to look at it in a serious, thoughtful, and intellectually honest fashion—then we would apply those criteria to that proposal and then try to make a judgment, why does it make sense for this country.

Senator D'AMATO. All right. And I do have several proposals I would like to share with you at a later time.

I know the issue about static and dynamic scoring.

Mr. RUBIN. Could I just make one more comment, Senator?

Senator D'AMATO. Certainly.

Mr. RUBIN. I think it is a fairly obvious comment. But the more that the tax benefits go to the higher income taxpayers, the more weight you are putting on the economic growth benefits because as you think through the judgment process, it is a kind of a weighted average sort of thinking process. I did not mean to interrupt you.

Senator D'AMATO. No, no. That is quite all right.

On this issue of dynamic scoring, I note that when GATT was passed, and I think there was something like $11-12 billion in terms of revenue, the administration did look to job creation in terms of evaluating what the bottom line would be. Was that not involving principles of dynamic as opposed to static scoring? Would they not take credit for job creation and, therefore, the economic loss would not be, if you scored it——

Mr. RUBIN. Senator, I think there has been a lot of understandable misunderstanding, and I think we have generated some of it ourselves, frankly, by the statements we have made about what our position was with respect to budget rules in GATT.

As I mentioned a bit ago, the President, from the very beginning, has said that he wants to have all numbers be real, be conservative, and be done in accordance with traditional budget processes.

When we came to GATT, we absolutely insisted that GATT be paid for, and there was a lot of pressure on us to waive the 5-year rule in the Budget Enforcement Act. And we said, no, we would not waive it, as much as we believed that GATT would produce income vastly in excess of that which would be foregone because we believed in the integrity of the system.

We did request a waiver of the second 5 years, which is a Senate rule, as you know, not part of the law in the Budget Enforcement Act. The view there was that GATT was the largest trade treaty in the history of the world. It would result in the largest tax increase, or tax decrease, I should say, in the history of the world.

It had enormous benefits, potentially, for this country, and it was coming to a vote at the end of the last Congress and it was very much our fear—and I think realistically so—that if it was not passed in the last Congress that it would unravel around the world, so we felt we were in a semi-emergency situation if this was going to get passed.

It seemed to us, under those truly extraordinary circumstances that one would make an exception and waive the second 5 years. But, even under those circumstances, we said we would not go ahead with GATT unless we could get the funding for the first 5 years.

And I will tell you, Senator, speaking for myself, even under those extraordinary circumstances, I found myself very troubled about waiving the second 5 years for the very reasons that you have just made, that it could be misconstrued as a precedent. I think there were unique circumstances.

Senator D'AMATO. Mr. Chairman, I know my time is up. I have one observation, if I might make it. Last week, the Banking Committee held hearings on the issue of, not so much derivatives—of course, they talked about derivatives—but one thing emerged. Highly leveraged investment strategies are something that I think we all had better be very careful about.

I do not think we want to have a blanket condemnation of derivatives because they certainly can be used to, in many cases, reduce risks, but it seems to me that the purpose of Federal deposit insurance is to protect depositor's funds and not to subsidize speculative risk-taking by financial institutions. Would you agree with that?

The CHAIRMAN. I thought you had an observation.

Senator D'AMATO. Well, that is my observation.

The CHAIRMAN. Go ahead, Bob.

Mr. RUBIN. Senator, I think your observation, which one could have construed as a question but I will construe as an observation, was well taken. You have raised a very complicated issue. Let me just say, we look forward to working with you in your capacity as Chairman of the Banking Committee on these issues, and I think it is an observation that is very sound and sensible.

The CHAIRMAN. I might corroborate one thing before Senator Chafee starts. I know on GATT we did static estimates, although I do not recall any economist from the right or the left that did not think it made money. But the reason we were delayed for so long was looking for that last $3–4 billion on the static estimate.

Mr. RUBIN. That is correct.

The CHAIRMAN. Indeed, we stuck with it all the way through.

Senator Chafee?

Senator CHAFEE. Thank you, Mr. Chairman.

Mr. Rubin, you gave great credit in your earlier testimony to deficit reduction that came about as a result of the 1993 tax bill and its benefits for helping small business. You say that that has been one of the great things that this Administration has accomplished. Yet it seems to me that we are abandoning that effort in favor of a bidding war between the administration, and certainly the House of Representatives, on who can cut taxes the most.

Now, what you have said here this morning is, that the President insists that for every tax cut there be a commensurate reduction in spending. But, when you do that, the deficit remains exactly the same. Am I not correct?

Mr. RUBIN. That is correct.

Senator CHAFEE. If you get $1,000 of spending and $700 of income and you cut your spending by $200 and you cut your taxes by the same amount, your deficit is exactly the same amount in dollars.

Mr. RUBIN. Correct.

Senator CHAFEE. All right. Now, where do you get deficit reduction under that system? In other words, I feel very, very strongly, as you and I discussed, that our focus should be to reduce these deficits.

I have just come off a campaign, and I will tell you, I was not overwhelmed by people who wanted tax cuts. Capital gains is a separate subject, and we will discuss that separately. But should we not concentrate on reducing this deficit?

Mr. RUBIN. Senator, there are several parts to that question. Let me try to respond to each one of them. This administration has absolutely no interest in engaging in what you refer to as a bidding war on taxes.

The President has put forth what he feels—and I happen to very much agree with him—is a very sensible middle class tax reduction program that is fully paid for, and that is his program.

He said from the very beginning of his campaign, and then into the administration, that he had a comprehensive, broad-based economic strategy, that the issues of the Nation were complex, and, as a consequence, you could not have one or two proposals or one or two initiatives to deal with the complexity of those issues, but you needed a multi-faceted program.

One aspect of his program—and it was the threshold one as it turned out because the circumstance was deficit reduction—is he always felt, Senator, that when the circumstances allowed, we should also have a set of middle class tax cuts for the reasons I mentioned a few moments ago.

When our budget comes out—and it is being submitted on February 6th—I think what you will find is that we do continue to pursue deficit reduction while pursuing many other ends at the same time: the middle class tax cut, which we can now afford and which he felt we could not afford in early 1993, education, training, and various other initiatives that he thinks need to be pursued. The deficit, when that budget is submitted, will, I think you will see, continue at a very substantially lower level than it had been prior to the efforts that we took in 1993.

Obviously, there is a lot more to do and he is committed to doing it. And, as he said, over the last two years, when the deficit starts going back up the end of this century, early next century, it is in the context of the health care entitlements being the driving force.

And he feels that Federal health care expenditures need to be addressed with respect to the deficit, but, as you very well know because you were leader in that effort, only in the context of health care reform.

Senator CHAFEE. Well, Mr. Rubin, I get discouraged when I look at these figures. Yes, the deficit has come down to $176 billion for the current fiscal year, but then it starts upward. In 1999, unless something different is done, and it will be $253 billion.

You have got your family here. I do not know how we can face these children and grandchildren if, in times of relative tranquility we cannot bring down this deficit. If the promises are that, oh, we are going to give a middle class tax cut, and you are going to require a commensurate reduction in spending to pay for that tax cut, you have not gotten anywhere with the deficit. What do we say to our children?

Mr. RUBIN. Senator, I think that there are a lot of issues on which we need to have answers for the next generation. I personally believe, as you do, that deficit reduction is a very important one, but it is not the only one. I think if we do not provide adequate education and training, Senator, we will not be equipped to compete in a modern world.

I also think that we have had a terrible problem in terms of the increasing income inequality over the last 20 years, and the middle class tax cut is a small, but nevertheless significant, move through tax fairness in trying to offset that to some extent.

The purposes of the three cuts that the President has proposed will, I think, provide additional investment through the activity of the individual affected that hopefully will increase productivity and increase incomes in the years ahead.

Having said all that, Senator——

Senator CHAFEE. Mr. Rubin, we can follow that song a long ways, though, can we not? I mean, that is a great justification for any tax cut. Now you are into the dynamic scoring debate, are you not?

Mr. RUBIN [continuing]. No. Oh, no. No, I'm not. I think you have to distinguish two different things. Every single one of these tax cuts is fully paid for under current budget methodology.

Having said that, once it is fully paid for then you also have to say, as the President says, what effect will it have on job creation, what effect will it have on standards of living, and what effect will it have on tax fairness? So then you have to see what benefits you are going to get for the tax cut that you are providing.

Let me add, if I may, Senator, and I do not want to prejudge or prediscuss the budget because it has not been submitted yet, but I think when you see our budget submitted on February 6th, relative to the numbers that you have just mentioned, I think that you will feel that we actually have done a fair bid on deficit reduction.

Senator CHAFEE. Well, Mr. Chairman, let me just say, am I the only—oh, Senator Conrad.

The CHAIRMAN. Senator Conrad and Senator Simpson.

Senator CHAFEE. Senator Simpson.

Let me just make this observation. We get away with observations, I guess, after the red light. Let me just observe that in your remarks here you have laid great emphasis on the benefits that have come from the deficit reduction. If it is wonderful—and I think it is—then we should keep going on that track?

My feeling is that it ought to be the top priority. Yes, we all love tax cuts. I do not care whether you are rich or whether you are poor, everybody likes tax cuts, but I think the best thing we can do for this country is to concentrate on deficit reduction.

Mr. RUBIN. Senator, we would agree with you that deficit reduction is extremely important. If there is any difference at all, I think it may simply be that we think that there are a number of priorities that have to be pursued at the same time.

Senator CHAFEE. Thank you.

Thank you, Mr. Chairman.

The CHAIRMAN. Senator Simpson.

Senator SIMPSON. Mr. Chairman, let me say, this is my first opportunity here to serve on this committee. It is a great privilege and honor to do that, to serve with you, Mr. Chairman, and Ranking Member Senator Moynihan, two men I have always enjoyed and greatly admired for their energy and their intellect. It is a great privilege, to serve along with the other members of the committee.

I am on the committee, not to bump somebody else off, so that we can get that right out of the area. I have already talked to Senator Gramm and Senator Lott many weeks ago. But the media does not seem to understand it yet—which would not be the first time they never got it—that the reason I am here is because of service on the Entitlements Commission, which was the greatest suicide effort I have ever been involved in.

And, after serving there with Senators Kerrey and Danforth, two people who really did yeoman work, and others of the Senate. Carol Moseley-Braun was a member of the commission and she gave us great insights which were extremely helpful. I think she and I largely concur on many things. But there is where we are. We are dealing with something, get this figure. I heard Senator Chafee, in talking about the deficits, and Mr. Rubin, I have talked with you and I admire you greatly. I have come to know you and I am willing to help you in any way in your work.

But, in the year 2013, and with no increase in tax rates, there will be sufficient funds to pay only for entitlements and interest on the debt. While this figure includes all entitlement programs, all of the projected growth above inflation that leads to this result would come from four programs alone—Social Security, Medicare, Medicaid, and Federal retirement. Now, that is the report of the Commission, in the year 2013, and 30 of the 32 of us agreed on that. So, we will have to now, I suppose, sit and listen to why we should get rid of Lawrence Welk's boyhood home, tse-tse fly studies——

Senator CONRAD. Easy, easy.

Senator SIMPSON [continuing]. I knew that would get a rise. [Laughter.]

That is all right. Relax. We are not going to do that. Tse-tse fly studies, foreign aid, get rid of foreign aid, and waste, fraud, and abuse. And doing all that would probably be about 1–3 percent of the Federal budget, which is $1.506 trillion, with a debt that we are going to vote on in March, a debt limit will be $5 trillion, which is now $4.9 trillion, or something. It will be $5 trillion. So there we are.

I do not see how are going to get anywhere without doing something about the big stuff, and that is why I came here. That is why I visited with Senators Lott and Gramm and told them exactly why I was seeking a position here after expending nearly a year of my time on the Entitlements Commission.

You are going to serve very well in your capacity as Secretary of the Treasury, and with a similar steadiness and honor as our former colleague and an old friend of mine, former Senator Lloyd Bentsen.

You have assured me of your commitment to controlling the explosive costs of entitlements and driving down the deficit and I think you know that I feel that we will not get anywhere by tinkering around the margins of deficit reduction with the stuff that I just talked about. So, I look forward to working with you.

I would ask you this question, do the options that you plan to review in order to reduce the deficit include any entitlement programs, and if so, which ones?

Mr. RUBIN. Senator, as you and I discussed, the pressure on the deficit that comes from entitlements that begins in the end of this decade and into the next decade comes, in the first instance, from health care entitlements. The President, for 2 years, talked about this very issue, which was Federal health care expenditures, and bringing down the rate of increase of Federal health care expenditures.

Not decreasing them, but bringing down the rate of increase of Federal health care expenditures, but within the context of comprehensive health care reform, because otherwise, as you and I discussed, you have distortions, cost shifting, and other kinds of undesirable activity.

The President is still very much totally committed to the vision that he set forth over the last 2 years of comprehensive health care reform. As he said in a letter that I know he sent to Majority Leader Dole and to Speaker Gingrich, he would very much like to focus on seeing how many steps we can take toward that objective this year.

I think that should be the first order of business over the next few years, try to get in place health care reform. That, amongst other things, in addition to providing coverage for all Americans, also puts under control Federal health care expenditures so that we can deal with that driving element in the deficit.

The President is fully supportive of the Social Security system into the next century, as you say, because of demographics and inflation, particularly demographics. Issues arise with respect to Social Security and, as you and I discussed, I guess it was yesterday or the day before, that is going to have to be dealt with on a bipartisan basis when that time comes.

Senator SIMPSON. Well, Mr. Chairman, one of the things that Mr. Rubin will do, he will go on as the Chairman, I think, of the Social Security trust organization. During the Entitlements Commission work, we have found that they have moved up the doomsday date 7 years in 1 year.

In other words, Social Security will be broke in the year 2029. Last year they said it would be 2036. In one year, the trustees moved up the doomsday date 7 years. Now Mr. Rubin will chair that group.

Mr. RUBIN. But not in 2029.

Senator SIMPSON. No, but not in 2029. Nor will all of us be staggering around.

Mr. RUBIN. Senator, as you know, there is a report or a commission that actually is looking at the Social Security trust fund. Do not hold me to this, but I have a vague recollection that that report is due sometime in April or May. Obviously, when it comes, we will look at its recommendations with great seriousness.

Senator SIMPSON. Well, I thank you. I look forward to working with you and I commend you on your forthrightness in my dealings with you. Thank you.

Mr. RUBIN. Thank you.

The CHAIRMAN. Senator Simpson said one thing about Social Security being broke in 2029. That is true, but it starts paying out more money than it takes in about the year 2012, or 2010, give or take a couple of years. At that stage, all Social Security has is government bonds.

You will not be the Treasury Secretary then, but at that stage the Social Security Administration comes to the Treasurer of the United States, I assume, and says, here, give us some money for these bonds. And the Treasurer says, we spent that 20 years ago. What do you mean, give you some money for these bonds? Either we raise taxes then to pay for it, or we find it someplace, or we trim benefits. But we should not be saying, oh, well, we have until 2029. We have to redeem those bonds within a generation.

Mr. RUBIN. Mr. Chairman, there clearly are issues with respect to Social Security, I agree with that. But I think it is—and you know far more about this than I do—equally true that that is going to have to be dealt with on a bipartisan basis.

The CHAIRMAN. Oh, absolutely.

Senator Conrad?

Senator CONRAD. Thank you, Mr. Chairman.

I would like to welcome our new colleagues. Senator Simpson, who is here on the Republican side, Senator Graham, Senator Moseley-Braun, who are present this morning. I think they will make a great contribution to the work of this committee.

I also want to welcome Mr. Rubin, who I think is just an outstanding choice to be the next Secretary of the Treasury. We face a very difficult time. I think we have heard this morning why it is so challenging. The fact is, we have got to get our fiscal house in order. I just came from a press conference in which we were talking about the balanced budget amendment that is before Congress now. And in order to balance the budget by the year 2002, we have got to have $1 trillion. That is not billion, that is not million, that is $1 trillion of program savings.

The Republicans on the House side say the first way to start down that path is to have $200 billion of tax cuts. On top of that, the Balanced Budget Amendment that they have on the table would loot the Social Security trust fund of over $600 billion in order to begin to reach balance. What a fraud.

I just had a press conference in which I said it reminded me of the Reverend Jim Baker, who just got out of Federal prison for fraud. His guilt was saying he was raising money for one purpose and using it for another. That is precisely what we are doing with Social Security surpluses today.

We tell people, we are imposing this regressive payroll tax on you because we are using it to fund Social Security. What a game. Some of it is used to finance Social Security, but this year $69 billion of surplus will be used to finance the other programs of government.

Mr. Rubin, I believe deeply and strongly that deficit reduction is necessary, not because it is something that is some sort of moral crusade, but because it makes a difference in the lives of people.

The difference it makes in the lives of people is if you reduce the amount the Federal Government is spending over and above what it takes in, then you relieve the pressure on interest rates. Interest rates are lower than they would otherwise be, and that fuels economic growth and economic activity in this country. And I believe the last 2 years have confirmed it. They have confirmed it.

We put in place, without a single vote from our Republican friends, not one, a plan that did cut spending, that did raise taxes on the wealthiest 1 percent, so we would reduce the deficit, and it worked.

The deficit was $290 billion in 1992. This year it is going to be $176 billion, a 40 percent reduction. And the results? We got the lowest interest rates in 20 years, the strongest economic growth in 9 years. Should we not stay on that path? That would be my question.

Mr. RUBIN. Senator, I think that we should remain committed to the path that we started on in early 1993, as I would view it, is the path of getting this country's fiscal house in order, which I believe we did do with the deficit reduction program the President proposed and Congress enacted in 1993, and then I think we should continue to make sure that we have the discipline every year to stay on that track.

And, when our budget is submitted on February 6th, I think you will see that we have, in fact, had that discipline. Then as we go forward, I think we have to deal with the issues that a number of others have raised today, so that over the long run we can continue to get the deficit down, both in absolute terms, and as a percentage of the total GDP or economy of the country.

Senator CONRAD. Let me just say to you, I think the proposal on the Republican side in the House is utterly irresponsible. $200 billion of tax cuts. It is a little like having your family at the dinner table and you bring in the dessert before you had your meat and potatoes. I think it is utterly irresponsible. We ought to, in this country, get the deficit down.

We have still got a deficit, although we have made significant progress. We ought to take that pressure off of the financial market so that interest rates can be reduced. That is the real benefit to middle income people in this country, is to get interest rates down.

Let me just ask you, do you believe, Mr. Rubin, that if we had significant additional deficit reduction this year, not talking about the sweet by and by, not talking about tomorrow as our friends on the other side, they want to pass a Balanced Budget Amendment. The problem is, a balanced budget 7 years from now. They do not want to start doing the hard work now.

In your judgment, you are somebody who has been deeply involved in the financial markets of America, if we had significant deficit reduction this year, do you believe that would assist us in getting interest rates down?

Mr. RUBIN. Well, if we brought the deficit down below—by this year, do you mean government fiscal year 1996? What year are you talking about?

Senator CONRAD. 1996.

Mr. RUBIN. Because we are now in fiscal 1995. But you are talking about 1996.

Senator CONRAD. Well, I would be glad to work with the recision package.

Mr. RUBIN. No.

Senator CONRAD. In effect, 1995 is what——

Mr. RUBIN. No, no. I was just trying to understand what year we were talking about. All right.

I think what you would have is a trade off. When you see our budget, what you will see is that we continue to have substantial discipline, real discipline, in getting the deficit way below where it otherwise would have been.

If you had additional deficit reduction below that which is included in our budget in 1996, on the one hand, you would have a negative macroeconomic impact. That is from the lower deficit.

On the other hand, would you have sufficiently lower interest rates to offset that so that we could maintain the same growth of GDP that we otherwise would have had? Senator, I would have to look at the particular proposal that you had, and then we could sit down and analyze it. I would be delighted to do that with you. But that is a judgmental matter.

I think the critical thing right now is that we do not do something that gets our deficit off the discipline track that we are on. The deficit will go up and down year to year, depending on the circumstances.

But we are on a discipline track, and I think the critical thing is that we remain on that discipline track and then, over time, deal with the larger issues that have been raised by a number of the other members of this panel.

Senator CONRAD. Mr. Chairman, if I might.

I would just follow it up by saying it this way to you. Is there anything we could do, other than reducing the deficit, that would take pressure off of interest rates?

Mr. RUBIN. That is a very good question, Senator. Interest rates, as you know, are going to reflect growth and inflationary expectations. In the period prior to the beginning of this administration, I think there was one other factor in long-term interest rates, and those are the rates that basically drive this economy, and that was a premium that long-term rates had because investors were afraid of the deficit and they were afraid that ultimately the government would not have the discipline to deal with the deficit and, therefore, they would inflate their way out and long-term financial assets would become worth less.

I really believe that, as a consequence of the deficit reduction programs that have been put in place and the discipline that has been evidence, and I hope will continue to be evidenced on a bipartisan basis, that that deficit premium is largely out of long-term interest rates. Therefore, it seems to me, long-term rates ought to remain consistent with solid growth over time.

I think the thing that we can best do is to make sure that we have an economic policy that is sound and sensible that does not get us off the disciplined deficit reduction path that we are on.

Senator CONRAD. I thank the witness, and I thank the Chairman.

The CHAIRMAN. Let me ask you a question. In 1980, the deficit was about $60 billion, inflation was around 13–14 percent, and long-term interest rates a few points above that. Ronald Reagan campaigns on the theme that these deficits are driving this inflation; elect me, and we will reduce the deficits. He gets elected. The deficits go up immensely and the interest rates absolutely plummet. Why?

Mr. RUBIN. Well, that is a good question, Senator. I think you had two sets of things happen, and I lived through this as a participant in the financial markets. It was kind of interesting to watch it. I think a lot of people saw what was happening and really greatly feared the end game in this.

In the very beginning, as you remember, we had a recession in 1982. So, with a recession, you obviously would have lower interest rates. Subsequently, you had, as you correctly say, an enormous increase in the deficits. The Federal debt, if I remember correctly, quadrupled in the 1990's. Yet, interest rates never went to the levels that people had been concerned about that projected.

I think what happened—and I actually was a participant in this; I saw it happen firsthand—is that the unexpected development—and the unexpected often happens in the economic arena—is that this country attracted vast supplies of capital from abroad, particularly Japan.

And, for a long time, our interest rates were lower than they otherwise would have been because of the globalization of the international financial markets, a phenomenon which really occurred during the 1980's.

The thing that so troubled me and many others—it was bipartisan, not just because I was a Democrat—who tried to be thoughtful about the longer term prospects was that this could not go on forever.

So, the fear was, what would happen when there was no longer this vast inflow of capital from abroad? And the answer to that, unfortunately, came to pass in the latter part of the 1980's and the early 1990's.

The CHAIRMAN. Let me—and I have got a letter from Dr. Reischauer—go back to 1980, 1981, because often that period has been accused of being the Reagan supply side economics. From roughly February of 1980 until about mid-summer of 1981, roughly an 18-month period, we were predicting immense surpluses by 1985. CBO's estimate was $150–250 billion surplus.

The Reagan tax cuts fell into two forms. One form was to reduce the projected surplus on the theory that if we did not give it back to the taxpayers we would spend it. I think that is probably correct, we probably would have. The President also had some tax cuts premised on spending cuts. He never got the spending cuts, but that was a smaller part of it. The second form of tax cuts came because Congress one-upped him. The House one-upped the President, we one-upped the House, and then we went to conference and took the most expensive tax cuts in either bill and sent it down to him.

But, interestingly, in 1981, Treasury's testimony as to the tax cuts was a static estimate. They presumed $150–200 billion in lost revenue because of the tax cuts which would be taken from the surplus that we expected.

What we did not foresee were three things. One, we did not see the recession. Nobody foresaw it. Two, we did not see the inflation coming down as rapidly as it came down, and this was before we had indexed the code. So we could always figure on collecting about 1.6–1.7 percent increase in revenues for each one point increase in inflation because of no indexing. Well, we indexed the code in 1981, and it did not go into effect until 1985, but we had projected this immense revenue flow on high inflation.

So, I just want the record to indicate that at least the Republicans, in 1981, were not presuming supply side economics. I have Treasury's testimony, and I have Dr. Reischauer's letter—that it was a dollar for dollar cut.

I want to come back now to what Senator Moseley-Braun and I were pursuing, and some others, on this static versus dynamic estimates. And let us go, again, to the Bush capital gains proposal. I am going to use an example.

Let us assume that a capital gains transaction had a $10 per transaction tax. Forget the value, just assume a $10 per transaction tax. Assume that you had 10 transactions a year, for a total tax of $100.

So somebody says, well, let us cut the tax to $5. And, all other things being equal, in order to get $100, you would have to have 20 transactions instead of 10. When Treasury estimated the capital gains tax cut for President Bush, they estimated a $12 billion surplus, while the Joint Tax Committee estimated a $12 billion loss. They were both, however, doing what I would at least call behavioral estimates.

In essence, Treasury was saying, well, instead of 10 transactions we will get 21, so we will get $105. The Joint Tax Committee was saying, we will get 19, we will get $95, so we will lose $5. They were both within the margin of error. They were estimating it on trillions of dollars of transactions, and to come that close is amazing, but in both cases they were using behavioral estimates.

Now, I will make this distinction and ask your judgment. Everyone knows what static is: double the tax rates, double the collections; quadruple the tax rates, quadruple the collections; multiply it 10 times, 10 times the collections. Conversely, cut the tax rates in half, the tax collection is halved. It is static, nothing changes. Well, clearly, that is not correct. There is a behavioral change someplace along the way.

So, I think what Joint Tax and Treasury tried to do on capital gains was to limit their concept of the behavioral change to capital transactions, at least. They did not try to say, well, if we cut the capital gains tax rates, how many more acres of wheat will be planted, how many more homes will be built?

You start getting into that, and I am not sure there is a way you can model that. It would be like trying to model the hula hoop. Nobody could have modeled that, and we sold millions of them.

But it clearly was something other than static. I think dynamic is the one where you just say, well, we are going to estimate what the Gross Domestic Product is going to be, and it does not matter how we got there, there is no way to figure it anyway. We do do behavioral studies, no question.

How do we tread that line that says, well, really, static is foolish. There are changes in behavior without going wild.

Mr. RUBIN. Mr. Chairman, that is a very good question. And when I first came into this job, oh, some months after that, and I became aware of these rather, in some cases, peculiar scoring rules pursuant to which the Federal budget has done, one of the questions I asked was the very one you just asked, because I had heard that we had something called static scoring, and I did not know what it was. Then somebody said, well, it is static scoring, but there are some differences, and they took me down the line on behavioral. And I said, well, that is interesting. Then they said, well, we do not do the GDP projections.

The answer that I was given, and it is something that I made a note to myself to inquire further about when I get to Treasury, is that economists are much more comfortable making the behavioral, the micro, judgments than they are the macro, the GDP, judgments, and that very responsible, serious people looked at this and feel there was a substantial difference in the probability of success with respect to those two types of judgments, and that is why the distinction is made.

The CHAIRMAN. And when we get to the capital gains debate, we are both going to be on behavioral estimates. It is going to be a question of how much behavior will produce how much money.

Mr. RUBIN. Oh, sure. And you know far more about this than I do, but within the models that, as you correctly say, have these behavioral characteristics, there can be good debates about what that behavior ought to be.

The CHAIRMAN. Well, it was amazing. Of course, a big issue was made about the rich will benefit. But to come within a plus or minus $12 billion on trillions of dollars of estimates over 5 years, is almost de minimis in terms of how close were you.

Mr. RUBIN. I have been told by people, and, as I say, I really am going to take a much closer look at this if confirmed and I get over to Treasury, that on a lot of this behavioral estimation, serious economists have a fairly high degree of confidence and conversely, on the macro, have a very low degree of confidence.

The CHAIRMAN. That is correct.

Senator Graham?

Senator GRAHAM. Thank you, Mr. Chairman.

I admire the mental acuity of our soon-to-be Secretary, and also his tenacity in staying here, which is longer than maybe had been originally anticipated. I think the length of the inquiry is a reflection of the respect for your opinion and judgment, and I hope bodes well for future relationship with this Congress and committee.

Bob, I would like to continue to pursue the question of fiscal responsibility and the effort to lower interest rates, particularly long-term interest rates. I think one of the great accomplishments of the administration was in the period in the fall and winter of 1993-1994 when long-term rates came down dramatically and many millions of Americans refinanced cars, houses, and other things.

It has been estimated that during that period that the total savings may have been as much as $100 billion in what middle Americans did not pay in their interest rates on consumer items.

Let me throw out three statements that have been made to me in discussing the question of what might be done to enter into another period of significant reduction in long-term interest rates.

The first, is that we have already absorbed all of the benefit in reducing long-term rates that can come from further deficit reduction, that what is maintaining long-term rates at their current level is a global competition for these funds as areas in and outside the United States begin to desire to attract these investment funds. What are your comments on the statement that this is really beyond our National economic sovereignty and is a function of global competitiveness for investment capital?

Mr. RUBIN. I do think that there is a generally prevailing view that real interest rates, the rate of interest over the rate of inflation on the long end of the spectrum, are considerably higher than you would expect them to be, given where inflation is.

My own view—and I had this view before I came to this job—is that the 1990's are likely to be—well, then I thought were likely to be, now I would say are likely to be, a period of enormous competition for capital around the world, and that it is very likely that real interest rates for any given level of inflation and growth will be higher than they would have been in prior periods.

I noticed in the New York Times not too long ago, Larry Summers was quoted as saying he thought it could be as much as 1.5 percent on the long bond. To me, that seems a touch on the high side.

I asked Larry how he got it, and he gave me some long answer I did not understand. But, in any event, he thought he was right. And even though I didn't understand his answer, I think he is wrong. But, in any event, whether he is right or wrong, we both agree that real interest rates are likely to be high in the 1990's for the very reason that you said, Senator.

But that is a two-edged sword. Those higher rates, obviously, are a deterrent to growth in this country. That is bad. On the other hand, they reflect increased demand around the world for our goods and services. That is good. What that balance is, I do not know.

I think that the best thing we can do to have lower long-term rates is to have the international financial markets be confident that we are going to continue to have a disciplined approach to deficit reduction.

We are very watchful with respect to inflation. I would say all of the senior members of the economic team are people of great experience in the various things they have done. We have lived through inflation before, we do not want to live through it again. It has enormous problems. We do not want to experience that again.

Having said that, I do think that there are forces operating in the world today—globalization, the application of technology in services, the rapid increase in the rates of technological development—that may provide more latitude in the capacity rate of growth of the economy and of the level to which unemployment can go before you begin to encounter an inflation problem than is generally expected. If that is true, then over time the markets will come to realize that and that will affect the long-term rates. If I could just make one more comment.

Obviously, the programs that I think of as public investments, but training and education, the economically distressed area programs, as they increase productivity in the country, that, too, should help bring long-term rates down.

Senator GRAHAM. Bob, a second comment that I have received to my inquiry is that the most significant thing that could be done to deal with long-term interest rates is to pacify the investment community's apprehension that in the early years in the next century countries all over the world are going to hit the demographic wall that we are going to hit, and that is, as the generation born immediately after World War II reaches retirement age.

And there are going to be tremendous pressures, not only on the U.S. economy and public finance, but all the other industrialized nations, and there are steps that we could take today to give some signal that we are dealing with that issue. I think some of the suggestions that were probably before the Entitlement Commission would be of the ilk that were being intended.

What is your thought about the importance on immediate long-term interest rates of our dealing today with the implications of the entitlement costs in the 21st century?

Mr. RUBIN. Well, as you correctly say, there are many countries around the world, particularly large economies, that face the kinds of demographic problems that we do. I think the most constructive thing that we could do is do exactly what the President has tried to do for the last two years, which is to get a serious approach to health care reform in this country.

We recognize that is not going to be done all in one year, but, over time, to try to put in place in this country a comprehensive health care reform program that, amongst other things in addition to extending coverage to all Americans, would bring Federal health care entitlements under control within the context of health care reform. I think that is the single most important thing that we can do over the next few years.

The CHAIRMAN. Senator Moseley-Braun?

Senator MOSELEY-BRAUN. Mr. Chairman, I would love to continue this conversation, but I will not. So, I will pass on any further questions.

The CHAIRMAN. I have a couple more. I told Mr. Rubin when he came in it might be 12:30 a.m. and we are easily going to make that. You earlier indicated that anything that is going to be done on Social Security, I think you said, or maybe you said entitlements, has to be done on a bipartisan basis.

Mr. RUBIN. On Social Security, I said.

The CHAIRMAN. On Social Security.

Mr. RUBIN. Hopefully we would do health care on a bipartisan basis as well.

The CHAIRMAN. Yes. I understand what you mean. We cannot have one party taking the lead on Social Security and getting beaten over the head with it, and then being afraid to approach it again for the next generation, remembering what happened.

As Chairman of the Finance Committee, I was willing to approach the issue of Social Security with the suggestion to increase the retirement age, and perhaps limit the cost of living adjustments. Would the administrative be willing to join me on a bipartisan basis?

Mr. RUBIN. Senator, we do not have any Social Security proposals before us right now.

The CHAIRMAN. Is that the answer?

Mr. RUBIN. I think that is the answer I should give at this time, yes.

The CHAIRMAN. I understand.

Let us go back now to savings and investment. For a long time we have had a Tax Code that certainly favored consumption, or tilted toward consumption, and we made some slight, modest changes in it in 1986, like the elimination of consumer interest deductions.

But you heard the same pitch I did, that we need to save more, we need to invest more, that it will increase our productivity. That means better paying jobs and probably at a higher technical level where you require a lot of capital investment and will do well in the world. I think that premise is probably correct. Do you agree with that?

Mr. RUBIN. Yes, I do, Senator.

The CHAIRMAN. As I say, there is a body of opinion, a minority body, that does not agree with that. There would be some industries that would not be wild about moving toward investment rather than consumption. But, for the moment, let us accept the presumption.

Now, in order to get more savings and investment, does that mean we may have to consume less now?

Mr. RUBIN. Well, by definition, if we can increase the savings rate in our society we will, by definition, reduce the consumption rate.

The CHAIRMAN. All right.

Mr. RUBIN. So I think the answer to that question is yes. However, you can still have—I think I may see where you are going—full employment GDP, but what you will have is more investment and less consumption.

The CHAIRMAN. Yes.

Mr. RUBIN. And, therefore, you will be better prepared for the future. In fact, if you look at the last two years, this has been an investment-led recovery——

The CHAIRMAN. Yes.

Mr. RUBIN [continuing]. Which I think is very much to the long-term benefit of this country.

The CHAIRMAN. Now, you and I are on exactly the same wavelength here. My question is, what is the best way to increase savings and investment? I will give you two or three alternatives.

One, when you look at the history of the Income Tax Code—we did not start it until 1913—the rate, as I recall, was a maximum of either one or 5 percent on incomes above $500,000, and there were no deductions. Nobody cared. What difference did it make with rates like that? Then we finally began to put in charitable deductions, and it went way up in World War I and did not come down much till 1921. We put in capital gains.

The history of the Code has been basically this. The rates get so high that we have to put in exemptions and deductions to encourage people to do the things that we want them to do that they will not do because of the high rates.

As best I can tell, Ronald Reagan is the only person that must have paid the 91 percent rate. He remembers it very vividly. Everybody else found a way to get around the 91 percent rate, so it did not really matter.

And there are two ways to tax the rich. One is rates, the other is the base. If a person makes $100,000 and has $80,000 in deductions and you have a 90 percent tax rate, he pays $18,000. If he has $100,000 in income and $20,000 in deductions, you can tax him 25 percent and raise more money than under the higher rate. So you can get there either way.

My question is this. In order to encourage investment, should we be looking to try to do what we aimed at in 1986, which was to bring down the rates and get rid of the deductions? We actually ended up, on the personal income tax side, with a Code that was slightly more progressive after 1986 than before. Should we be aiming again in that direction?

Mr. RUBIN. Mr. Chairman, there are many variants of consumption tax, VATs, flat taxes, and I am sure there are many others, that all are aimed in that same direction. As you very well know, and know better than I, the argument that is made for them is that they will increase savings in one way or the other, depending on the structure of the particular tax.

The issues that are always raised are the same. Will it raise sufficient funds to offset the tax that is being eliminated or that it is replacing; will it affect the tax burden? Most of these proposals, although it may not be true of what you have in mind, tend to shift the tax burden away from the more affluent and toward the less affluent, though that does not necessarily have to be the case.

Are the deductions, the exemptions, the exclusions, and the credits, each of which has a policy reason for it—some of them may be pretty unattractive policy reasons, but, nevertheless, some of them are very important policy reasons.

The CHAIRMAN. Some of them were good policy reasons when adopted. They outlived their usefulness, but you have a dickens of a time getting rid of them.

Mr. RUBIN. Absolutely correct. That is absolutely correct. But does it make sense not to be serving those purposes anymore?

And then I think you have to weigh and balance all of these considerations, and then you can make a consider judgment. In the final analysis, I do not have a personal opinion. The only thing I think I would say to you is that it seems to me that all of these are very complex questions, the ones that I have just raised. And, if there is a particular proposal that you think is especially meritorious of review, we would be absolutely delighted to review it. I am talking about your more serious question.

The CHAIRMAN. This is more in theory, and Bill Bradley was the godfather of that 1986 tax reform. But I remember his advice to me, as we got down into the 26–27 percent level, that to get much lower than that we had to start limiting real property tax deductions, State and local income tax deductions, mortgage interest deductions; things that were so dear that we simply did not have the political weight to do it. Finally, we ended up with 27 percent in order to achieve what we wanted to achieve and keep the Income Tax Code as progressive as it had been before.

Here is what you could do, but you are absolutely right about the regressivity. We could raise as much money as we now raise from the personal income tax with a 12-percent flat tax. If you meant real flat, no deductions, no deductions for the widow that has $10,000 of income and two kids who pays nothing, would pay $1,200. That is not fair. And, as a rule of thumb, everybody who would make over $70,000 would pay less than they pay now, and everybody who made under $70,000 would pay more than they pay now.

But, absent that, if you went with a 12-percent flat tax, you would think most people who have a lot of money would say, oh, fine, I will pay it, and it will lead to more savings and investment, or would it not? Obviously, the savings and investment would be based upon economic investment, it would not be a tax investment anymore.

Mr. RUBIN. In theory, Mr. Chairman, if you had a tax proposal that very substantially reduced the tax rate of the most affluent, you would increase savings because the most affluent have the highest propensity to save. So that, I think, follows almost definitionally. The problem is, that you have done exactly what you have just said, and that is, you have shifted the tax burden from those who can best afford it to those who can least afford it.

I do believe there is another problem, though. I remember the 1986 Tax Code quite well. And, as you said, one of the big debates was a State and local tax deduction. I don't know how you felt about it, but I lived in New York City and I did not think it was a really good idea.

The CHAIRMAN. You were not alone of those who lived in New York City.

Mr. RUBIN. No. I think there were roughly seven million of us, most of whom you probably got the opportunity to meet. But there is a legitimate policy question which is, had you eliminated State and local, I think you would have had horrendous effects on New York City. Some people may say that is a good thing, but it would have horrendous effects on New York City, with all sorts of ramifications.

So, I think that these deductions have very significant economic impacts, and I think if you are going to go from a system with a lot of deductions to one with very few, I think you have got to determine what you are going to do with respect to the effects of each of those sets of deductions that you are eliminating.

The CHAIRMAN. When we were doing the hearings in 1986, I would ask the witnesses, "how low would the rates have to be before you did not really care about deductions?" And it would vary from 20–30 percent, but an average might have been 25 percent. I discovered that really is not true.

As soon as you get it down, they still want deductions and exemptions. I recall one person testifying on capital gains, because we kept it at 28, but in essence got rid of it, saying that there always have to be a differential or people will not invest. So, I said, "well, if we got the rate to 20 percent," he would say that capital gains ought to be 10 percent. If we got the rate down to 10 percent, he would say that capital gains ought to be taxed at five percent. I said, if we got it to zero, we got rid of the income tax, would you need a subsidy? [Laughter.]

And he said, well, if it got that low, maybe it would not make any difference. My hunch is, it would not. And what I am going to wrestle with, and I will be talking to you daily, do we want to move in the direction of—you are familiar with Nunn-Domenici and their concept. In its simplest terms, it is a consumption-based income tax. You make $100,000, you spend $70,000 and save $30,000, you pay no tax on the $30,000. I assume you would have to have some kind of an inheritance or State tax element or you are going to allow immense fortunes to be passed along with no tax. But, short of that, sooner or later people either spend the $30,000 or save it. I mean, there is nothing more you can do with it than spend it or save.

You do not have to answer this now, but should we be moving in that direction? Because, very honestly, what I fear, when you say 39.6, it is not really that when you add to it the Medicare portion that we took off for the upper income people. It is not really that for people that live in New York City. They are now in those upper income marginal rates above 50 percent.

At what stage—and it gets back to this supply side theory—at the marginal rates—how much is it on the last $10,000 you make? If it is 70–80 percent and you can make as much as you want in 8 months, you may not work the last 4 months.

How do we find the magic number, and should we be moving toward a Nunn-Domenici or tax reform concept, or flat tax concept, or should we encourage savings and investment with the deductions and the incentives that we will put into the Code. And you and I know what that means, every group in America is convinced that they should be at the top of the savings totem pole.

Mr. RUBIN. Again, Mr. Chairman, this is something that you have focused on a lot more than I have over the years and know a lot more about. My impression has been that the Nunn-Domenici ideas, the flat tax ideas, the VATs, the 1986 Tax Act, that conceptually those types of ideas, those types of programs, look very attractive.

But then as you get into the particulars, they become more and more difficult and, at least my impression is, that when you try to work your way through these you get to a crossover point where the conceptual attractiveness is outweighed by the particular unattractiveness.

Having said that, I think very rightly you raised the question of looking at these with great care and seriousness because there is the possibility at least that one could find something that really made some sense. We have no proposal of this sort in front of this administration at this time, let me very quickly add.

The CHAIRMAN. I am always inclined to look at things philosophically, first, and say, what is the goal you want to achieve. And if the goal is, let us try to encourage the investment without the Code tilting one way or the other, then you go in one direction.

If you say, no, the goal has to be that we will put into the Code the incentives that we want to direct the investment in the direction we want, they are both legitimate philosophies. In the latter case, you and I have to guess what we think the investments ought to be, and you favor some and not others.

Mr. RUBIN. Yes, I agree with that. On the other hand, if you try to move away from that, as we discussed a few moments ago, you have all of the other problems that I have just mentioned and that is why I think it is a very complex set of competing considerations.

The CHAIRMAN. Well, I know Congressman Armey and his flat tax attempted to get over the argument of regressivity. He tried to build into it lots of deductions for food, shelter, and clothing, and whatnot.

I have no philosophical problem with him, but I cannot make his figures pencil out at 17 percent, which is his flat rate after you allow the deduction. As I penciled it, it looks more like 24–25 percent. I may be off on that. If you could do what he wants and do it at 17 percent, I think you have achieved both a low enough rate to encourage investment, and kept the progressivity and the basic exemptions for middle income and poor. But I do not see the percentage figuring.

Mr. RUBIN. Mr. Chairman, we have also taken a look at that, as you know. It does seem to be substantially deficient of funds to replace the Tax Code that he wants to replace as one problem. Another, of course, is that you have greatly increased the after tax income, or greatly reduced, let us say, the tax rate on the most affluent.

And I think one would need to look at this with great care to make sure that you have not in some way or another increased the burden on others, if, in fact, you are still raising the same amount of money. Of course, there is something that does not sound like it quite fits.

The CHAIRMAN. One last comment. There were some critics of this in 1986. You say you are going to lower my rates and get rid of my deductions, and as soon as you do you will start raising my rates and I will not get my deductions back. They were, unfortunately, true. I know the argument and I can see a demagogue using it.

Let us say you could do it at 20 percent. Let us say you could raise as much money as you now raised and you could have progressivity. We would not have that for two or 3 years before somebody would say, "you mean to say that somebody that makes $500,000 pays the same percent as somebody that makes $50,000? Well, that is not fair, they ought to pay more." There you would start up on your progression of rates again. Eventually, when we got to 40, 45, 46, or 47 percent, we would start with the deductions to encourage the activity we want to encourage.

Anyway, you do not have to answer that. I do not see anybody else here, Mr. Rubin. I appreciate it. Let me come down and meet your family. We are adjourned.

Mr. RUBIN. Mr. Chairman, thank you very much.

[Whereupon, at 12:11 p.m., the hearing was concluded.]

APPENDIX

ADDITIONAL MATERIAL SUBMITTED

PREPARED STATEMENT OF SENATOR FRANK MURKOWSKI

INTRODUCTION TO THE COMMITTEE

Mr. Chairman, I have a very brief statement. I am very pleased to be joining the Finance Committee after 14 years in the Senate. As you know, since I arrived in 1981, I have sought to join this Committee because it's jurisdiction extends so broadly into the economic and social policy areas that weave together the fabric of our society.

I have always been struck by the capacity of the Finance Committee to meet the most important challenges of our day, nearly always in a bipartisan manner. That is a tribute to the leadership of the distinguished members who have served as Chairmen of this Committee.

I would just cite the fact that our Social Security system was saved from bankruptcy under the able leadership of then-Chairman Bob Dole, working with Senator Pat Moynihan. The single most comprehensive reform of the tax code succeeded only because of the tireless efforts of Chairman Bob Packwood. And under the able leadership of former Chairmen Lloyd Bentsen and Pat Moynihan, this Committee played a central role in moving forward international trade legislation including the U.S./Canada FTA; NAFTA and, most recently, the GATT legislation. I look forward to working with the Chairman and members on both sides of the aisle to continue the bi-partisan tradition of this Committee.

RUBIN NOMINATION

Mr. Chairman, I believe the President made a very wise decision in nominating Robert Rubin to be Secretary of the Treasury. As I told Mr. Rubin last Friday, he will have very large shoes to fill in succeeding Secretary Bentsen, whose confirmation was unanimously approved by this Committee two years ago before he even testified at his confirmation hearing.

I have no doubt that Mr. Rubin will easily be confirmed by this Committee and the full Senate. The knowledge and experience he gained at Goldman Sachs will be invaluable to this Committee as we consider impending tax policy changes and budget issues. Moreover, at a time when our NAFTA partner Mexico is enduring a crisis of financial confidence, I believe Mr. Rubin's international financial background will give the Administration a practical perspective on how the United States should help in bringing an end to the peso crisis.

I look forward to working with Mr. Rubin, and I thank the Chairman for allowing me to make this brief statement.

PREPARED STATEMENT OF ROBERT E. RUBIN

Mr. Chairman and Members of the Committee, I appreciate the opportunity to appear before you today, and I especially appreciate your willingness to schedule this hearing so expeditiously.

I'd like to thank my two home state Senators from New York, Senators Moynihan and D'Amato, for introducing me and for their kind words. And I'd like to thank Senator Graham from Florida where I grew up for his kind introduction.

I would also like to express my great respect for your long-time member and former Chairman, my friend of many years and colleague of the last two years, Secretary Lloyd Bentsen. He provided our Administration and our economic team with extensive experience, outstanding judgment, and consistent support for the spirit of teamwork. I look forward to his advice and guidance in the time ahead.

For the past two years, I have served in the White House as the Assistant to the President for Economic Policy and Coordinator of the National Economic Council, where a truly outstanding group of Cabinet members and White House officials worked together on the economic issues of the Nation.

Before that, I worked for 26 years at a major international financial institution headquartered in New York, where I had responsibility at various times for trading activities in debt, equities, foreign exchange, and commodities, as well as involvement in various domestic and international investment banking activities.

I welcomed the opportunity to join this Administration because I believed that this country was at a true economic crossroads, and that, with all of our natural advantages, our economic future could be robust—but only if we faced and dealt with the many problems and issues before us in a rapidly changing global economy. Conversely, I felt that if we did not face our economic problems, our economic prospects were likely to be mediocre as far into the future as the eye could see.

I strongly identify with the President's comprehensive economic strategy to promote investment-led economic growth with low inflation now, and to position the country for the long term. That strategy has been consistent from the beginning of the Administration. It consists of deficit reduction; education, training, programs for economically-depressed areas, and other public investments critical to future productivity; targeted tax reduction; reforming and reducing government and regulations; health care and welfare reform; and opening markets.

Through this strategy, our country, over time, can achieve fiscal order, strong productivity increases, and open markets, and so healthy long-term economic growth with low inflation, and all Americans can have the opportunity to share in that growth.

Much has been accomplished within this framework, often with bi-partisan support—but much remains to be done at this critical juncture, if our country is to prosper, both now and for the long run. Thus, in my opinion, it is crucial that the Administration and Congress work together effectively as we go forward. It is worth noting, in this regard, that this Committee in particular has had major accomplishments on a bi-partisan basis, including NAFTA and GATT.

Mr. Chairman, I am pragmatic, and I believe that differences can usually be resolved, not always but usually, by being straight-forward and focusing on substance. If confirmed, I will work with each Member of this Committee and with all Members of Congress in this spirit. I also believe that there are no easy answers to the significant issues of economic policy and that difficult trade-offs are almost always involved.

As we face the likely legislative agenda for the next two years, I would like to suggest a few guiding principles.

1. *Maintaining Fiscal Discipline.* Tax cuts or spending programs must be paid for, and we must sustain our efforts to continue reducing the deficit.

2. *Promoting Productivity.* We should endeavor to increase our national savings rate. And, within the discipline of deficit reduction, we need to continue to reorder the federal budget to emphasize education—which had strong bipartisan support in the last Congress—training, programs for economically-depressed areas, and other essential public investments. These investments in people are also key to equipping all Americans with the tools to participate in the Nation's economic growth and, thereby, to reverse the greatly increased income inequality that has developed over the last 20 years.

3. *Supporting International Cooperation.* In the new global economy, we need to open markets, we need to sensibly but effectively regulate the vast global financial markets that so critically affect all of the world's economies, and we need to help the developing and transitional economies.

4. *Modernizing Financial Markets.* We can make American financial markets more competitive and more efficient through modernizing regulatory structure and regulations, but the issues are very complex and competing considerations must be weighed carefully and thoughtfully.

Finally, if confirmed, I would endeavor to carry forward the United States Treasury's long and proud history of professional excellence and integrity, which I have admired from the vantage points of both Wall Street and the White House for many years. Treasury has been and should continue to be a reliable and trusted resource for Members of Congress and the general public. I also want to emphasize my commitment to Treasury's important law enforcement mission.

In conclusion, Mr. Chairman, I would like to thank you again for bringing me before this Committee so promptly. I hope my comments have been useful. Now I would be pleased to respond to any questions which you or the Committee may have.

RESPONSE TO INFORMATION REQUESTED OF NOMINEES BY UNITED STATES SENATE COMMITTEE ON FINANCE

NOMINEE: ROBERT E. RUBIN

NOMINATED FOR: SECRETARY
DEPARTMENT OF THE TREASURY

A. BIOGRAPHICAL:

1. Name: Robert Edward Rubin

2. Home Address: 911 Park Avenue
New York, New York 10021

Jefferson Hotel
1200 16th Street, N.W.
Washington, D.C. 20036

Office: The White House
Washington, D.C. 20500

3. Date and place of birth:

August 29, 1938
New York, New York

4. Marital status: Married, Judith O. Rubin
Maiden name: Oxenberg

5. Names and ages of children:

James S. Rubin, age 27
Philip M. Rubin, age 23

6. Education:

Miami Beach Senior High School
9/52–6/56
Diploma (6/56)

Harvard College
9/56–6/60
A.B. (6/60)

London School of Economics
10/60–7/61

Yale Law School
9/61–6/64
L.L.B. (6/64)

7. Employment record:

Assistant to the President for Economic Policy The White House Washington, D.C. 20500	1/93–present
The Goldman Sachs Group, L.P. 85 Broad Street New York, New York 10004	
Co-Senior Partner and Co-Chairman	12/90–12/92
Vice Chairman and Co-Chief Operating Officer	11/87–11/90
Member, Management Committee	12/80–12/92
General Partner	1/71–12/92
Associate	10/66–12/70

Between October 1966 and December 1992, I also served as an officer, director or partner of numerous entities affiliated with The Goldman Sachs Group, L.P.

Associate Cleary, Gottlieb, Steen & Hamilton One Liberty Plaza New York, New York 10006	9/64–10/66

8. Government experience:

Assistant to the President for Economic Policy	1/93–present
Member, Securities and Exchange Commission Market Oversight and Financial Services Advisory Committee	7/91–1/93
Member, New York City Mayor's Council of Economic Advisors	1990–1/93
Member, New York Governor's Council on Fiscal and Economic Priorities	1990–1/93
Member, New York Governor's Commission on Trade and Competitiveness	1/87–1/93
Member, Federal Reserve Bank of New York International Capital Markets Advisory Committee	1/89–1/93
Member, New York Governor's Advisory Panel on Financial Services	2/88–1989
Member, Commission on National Elections	2/85–1986
Member, President's Advisory Committee for Trade Negotiations	10/80–11/82
Member, Investment Advisory Council, New York City Pension Fund	1980–12/89
Member, Securities and Exchange Commission Advisory Committee on Tender Offers	1/83–8/83

9. Memberships:

See responses to Items 8 and 10. In addition:

Member, Central Synagogue, New York	1/77–present
Member, Council on Foreign Relations	1/94–present
Member, Century Country Club, New York	4/80–present
Member, Harvard Club, New York	1966–present
Director, New York City Partnership, Inc.	6/91–1/93
Director, New York Stock Exchange, Inc.	1/91–1/93
Trustee, Carnegie Corporation of New York	1/90–1/93
Vice President of the Board and Trustee, American Ballet Theater Foundation, Inc.	1969–1/93
Trustee, Channel THIRTEEN/WNET	6/85–1/93
Member, Committee on University Resources, Harvard College	9/87–1/93
Director, Library of Congress Trust Fund	1992–1/93
Director, Harvard Management Co., Inc.	11/90–1/93
Vice Chairman & Trustee, Mount Sinai Hospital and Medical School	1977–1/93
Vice Chairman, Center for National Policy	1982–1/93
Member, Regulatory Advisory Committee of the New York Stock Exchange, Inc.	12/88–9/90
Member, Board of Overseers' Committee to Visit Department of Economics, Harvard College	7/81–9/87
Director, New York Futures Exchange	3/79–2/85
Director, Studebaker-Worthington, Inc.	9/78–1979
Director, Chicago Board Options Exchange, Inc.	11/72–12/76
Trustee, Collegiate School (New York)	1978–6/84
Member, Board of Overseers, Graduate School of Management & Urban Professions, Center for New York City Affairs, New School for Social Research	1/78–1/83

I have also served as an officer, director or partner of numerous entities affiliated with The Goldman Sachs Group, L.P. I resigned all such positions in December 1992.

10. **Political affiliations – List all memberships and offices and activities:**

See Attachment A for a list of federal political contributions. See also responses to Items 8 and 9. In addition:

Chairman, New York City Host Committee for the 1992 Democratic Convention	8/89–7/92
New York State Finance Chairman, Mondale Presidential Campaign	1983–11/84
Chairman, Democratic Congressional Dinner for 1982	1982
Director, Democrats for the '80s	1/85–2/89
Director, Democrats for the '90s	3/89–12/90

I have met with, and provided informal advice on a variety of political and policy matters to, numerous candidates for national, state and local offices. I am a registered Democrat.

11. Honors and Awards:

Member, Phi Beta Kappa

Recipient, "Good Scout Award", Boy Scouts of America, 1990

Recipient, "Brotherhood Award", National Conference of Christians and Jews, 1977

12. Published Writings:

Author, op-ed article appearing in the New York Times, January 27, 1985 entitled, "Business Forum; High-Risk Trading Helps the Markets".

Member, the Cuomo Commission on Trade and Competitiveness, the report of which was published as The Cuomo Commission Report (1988).

Member, the Cuomo Commission on Competitiveness, the report of which was published as America's Agenda — Rebuilding Economic Strength (1992).

United States
Office of Government Ethics
1201 New York Avenue, NW., Suite 500
Washington, DC 20005-3917

January 5, 1995

The Honorable Bob Packwood
Chairman
Committee on Finance
United States Senate
Washington, DC 20510-6200

Dear Mr. Chairman:

In accordance with the Ethics in Government Act of 1978, I enclose a copy of the financial disclosure report filed by Robert E. Rubin, who has been nominated by President Clinton for the position of Secretary of the Treasury.

We have reviewed the report and have also obtained advice from the Department of the Treasury concerning any possible conflict in light of its functions and the nominee's proposed duties. Also enclosed is a letter from the ethics official of the agency dated January 3, 1995, which discusses Mr. Rubin's qualified diversified trusts and his ethics commitments with respect to recusals.

Based thereon, we believe that Mr. Rubin is in compliance with applicable laws and regulations governing conflicts of interest.

Sincerely,

Stephen D. Potts
Director

Enclosures

JK/jk(sh)
Rubin-278
Read File
Jan P.

DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

January 3, 1995

The Honorable Stephen D. Potts
Director
Office of Government Ethics
Washington, D.C. 20005-3917

Dear Mr. Potts:

The President has nominated Mr. Robert E. Rubin to be Secretary of the Treasury. As the Designated Agency Ethics Official of the Department of the Treasury, I have reviewed the information contained in the public financial disclosure report (SF 278) submitted by Mr. Rubin. Based upon my review of the information contained in the report, and considering the steps he has agreed to take upon appointment, it is my opinion that there will be no conflict between Mr. Rubin's financial interests and the duties he is expected to perform as Secretary.

As you know, upon his appointment as Assistant to the President for Economic Policy, Mr. Rubin placed all of his assets held for investment in three qualified diversified trusts that were certified by your office on February 5, 1994. Mr. Rubin has advised me that he intends to maintain those trusts upon his appointment as Secretary.

Mr. Rubin has also advised me that he will recuse himself from any particular matter that would have a direct and predictable effect on the ability of the Trust established under the Estate of Bernice Pauahi Bishop, a private educational charitable trust, to honor its obligations under the put guaranty agreement entered into by the Bishop Estate Trustees, the Northern Trust Company and Mr. Rubin on February 9, 1993.

Mr. Rubin has also agreed, as a prudential matter, that he will instruct the Deputy Secretary, the Executive Secretary, his immediate staff and other appropriate officials to consult with the Department's ethics officials before referring to his attention any particular matter involving The Goldman Sachs Group, L.P., any of its affiliates or the Bishop Estate as parties or representatives of parties appearing before any agency or department of the United States Government.

Finally, Mr. Rubin has agreed to work with officials of the Department of the Treasury to establish procedures to ensure that should any particular matters arise which, to his knowledge, would have a direct and predictable effect upon any financial interests he may have outside of the qualified trusts, those matters will be referred to another official in the Department for decision to the extent necessary or appropriate.

We believe that these procedures will eliminate the potential for any conflict.

Sincerely,

Dennis I. Foreman

Dennis I. Foreman
Deputy General Counsel and
Designated Agency Ethics Official

January 17, 1995

FOLLOW-UP QUESTIONS TO SECRETARY RUBIN FROM SENATE FINANCE COMMITTEE MEMBERS

CONSUMPTION TAXES

Question (Sen. Pressler):

Some have suggested that merely revising the current tax code is not enough. Though I have not quite come to that conclusion, I would like to get your thoughts on two alternative proposals: the flat tax and the national consumption tax. Do you believe either of these proposals has merit? In your opinion, is one proposal better than the other? Has either proposal been seriously studied by the Treasury Department?

Answer:

A flat tax could be a consumption tax or an income tax, depending on the treatment of income from savings. The flat tax proposed by Representative Armey, which exempts income from saving, is a form of consumption tax. Proponents of consumption taxes argue that they increase private saving, increase investment, and encourage domestic production for export. For these reasons, a consumption tax proposal deserves closer examination. A further analysis of the benefits are needed and, of course, we would need to look at the specific provisions before commenting. In particular, sector-specific issues need to be addressed, such as the tax treatment of financial institutions, imports and exports, non-profit institutions, state and local governments, and housing and other consumer durables.

To merit serious consideration, a proposal to replace the income tax system with a flat or consumption tax should at least: i) raise sufficient revenue, ii) maintain progressivity of the entire tax system, iii) include transitional rules to minimize windfall gains and losses, and iv) avoid additional costs of compliance and administration.

CORPORATE TAXES

Question (Senator Pressler):

What are your views regarding the rate of taxation for corporations? Do you foresee any changes in this area, including tax changes concerning foreign corporations operating in this country?

Answer:

The Omnibus Budget Reconciliation Act of 1993 increased the top corporate rate from 34 to 35 percent for taxable incomes in excess of $10,000,000. The Administration is not proposing additional increases in the corporate tax at this time.

The Treasury Department believes that the tax law should be applied so as not to discriminate based on whether a corporation is U.S.-owned or foreign-owned. All corporations operating in the United States should pay their fair share of taxes. The United States has undertaken several legislative and administrative initiatives in the past year with respect to earnings stripping, conduit transactions, transfer pricing and penalties in order to insure this result. Moreover, the Treasury Department continues to monitor this area very closely, and is prepared to take further action, if appropriate.

TAX SIMPLIFICATION

Question (Senator Pressler):

What are you and the Treasury Department prepared to do to further tax simplification?

Answer:

As the Assistant Secretary (Tax Policy) has stated in testimony before Congress on several occasions in recent years, the Treasury Department strongly supports the goal of simplifying federal tax laws. With respect to H.R. 3419 which was passed by the House of Representatives last year, we favored many of the provisions while having serious reservations about relatively few. We remain committed to working with Congress to develop a simplification bill that both Congress and the Administration can support.

In addition, when it comes to issuing regulations and rulings, the Treasury Department is very sensitive to the importance of minimizing the practical complexities taxpayers face in complying with the Internal Revenue Code. The Internal Revenue Service takes this into consideration when drafting tax forms and other kinds of administrative actions.

At the same time, we recognize that in attempting to measure taxable income accurately, especially in the context of sophisticated financial and business transactions, inherent economic complexities compel a certain degree of complexity in the tax rules. Our goal is to limit to the greatest degree possible, consistent with congressional intent, the extent to which these complex tax rules impose burdens on the taxpaying public.

FOREIGN SALES CORPORATION TAX BENEFITS FOR SOFTWARE

Question (Senator Baucus):

A 1987 temporary and proposed Treasury Department regulation denies software the same foreign sales corporation (FSC) benefits that are available to other products exported from the United States.

We enacted the FSC provisions to help eliminate competitive disadvantages suffered by U.S. exporters vis-a-vis their foreign competitors that had more favorable tax treatment of exporters, as well as to help keep the jobs involved in creating those exports in the United States.

Treasury's regulations would deny benefits to exports of software that are accompanied by the right of reproduction. In contrast, film, video and music products receive FSC benefits, even when the right of reproduction is attached. The result of Treasury's proposed regulation is that one of our most vital industries--computer software--does not receive the same benefits as other exports. Not only is this discrepancy inequitable, it does not make sense given that as modern technology advances, the distinctions between software products and film, video and music products are blurring.

Mr. Rubin, what are your views about changing the FSC regulations to remove their discriminatory impact on software?

Answer:

The expansion of the FSC rules that you recommend is a proposal the Administration does not oppose, and indeed, to which it is receptive. However, the proposal would constitute a significant expansion of the current FSC benefit and, as such, in the absence of express congressional direction, is more properly accomplished by a statutory amendment. If a legislative proposal were advanced with an acceptable budgetary offset, the Administration would be receptive.

CAPITAL GAINS

Question (Senator Hatch):

My first question deals with proposals to grant tax relief to lower and middle income class families and to reduce the tax on capital gains. Yesterday, I introduced a bill known as the Small Investors Tax Relief Act of 1995, which I call SITRA for short. That bill contains three provisions. First, it would allow individual taxpayers to exclude the first $10,000 of capital gains annually ($20,000 for a married couple filing jointly). Second, it would allow individuals to exclude the first $1,000 of dividend and interest income annually ($2,000 for a joint return). Finally, it would index capital assets so that capital gains taxes would not have to be paid on gains caused solely by inflation.

I realize that the Clinton Administration is opposed to the capital gains proposal contained in the Contract With America. Is the Administration's opposition to the Contract With America capital gains proposal due to a belief that the capital gains tax rate is not too high? Or, is the opposition to the proposal based on belief that the benefits of such a proposal accrue mostly to the wealthy?

Let me clarify for the record that I do not believe that the benefits of a capital gains tax reduction would overwhelmingly benefit the wealthy. I have seen much evidence that an across-the-board capital gains reduction such as the one in the proposal contained in the Contract With America would have widespread benefits to all income classes and to society as a whole. Treasury's own numbers indicate that 65 percent of all capital gains are claimed by taxpayers with adjusted gross incomes of less than $50,000.

My question to you is, do you believe that the Administration would look upon a bill that excludes the first $10,000 of capital gains annually differently than it does the capital gains proposal contained in the Contract With America?

Answer:

Before responding to your question, I would like to mention that, while it is true that a majority of the returns reporting capital gains have AGI under $50,000, most capital gains are reported by much higher income taxpayers. In 1991, the latest year for which final data have been published, taxpayers with AGI of $50,000 or less reported only 20 percent of all capital gains.

While the Contract With America would provide a 50 percent exclusion for capital gains to all taxpayers (corporations as well as individuals), we understand that your proposal is more targeted in two respects -- it is limited to individuals and would apply only to the first $10,000 of capital gains. However, because your bill would provide a complete exemption up to these limits, it is more generous than the Contract proposal in some instances (for example, to taxpayers with less than $20,000 of capital gains ($40,000 of capital gains for all joint filers)). We have not yet had an opportunity to estimate the revenue effects of this and other provisions of your bill, but we are concerned that they might have a significant revenue cost and that they are not sufficiently targeted.

I would also like to address the other two parts of your bill. We understand that, like the capital gains proposal in the Contract With America, your bill contains a provision to index capital assets. There are reasons why indexation proposals have been rejected, after careful consideration, in the past. Indexing the basis of capital assets for inflation would significantly increase complexity and distortions in the tax system. It raises many difficult problems of record-keeping and tax administration. Furthermore, the distinction between real and nominal gains is not limited to capital assets. A failure to index debt instruments would likely lead to a resurgence of the tax shelter type transactions of the 1980s and to other forms of tax arbitrage. In addition, indexation would lead to dramatic revenue losses which would have to be offset in order to avoid eroding the progress that we have made in deficit reduction.

Finally, we understand that you propose a limited exclusion for interest and dividend income of individuals. Until 1986, the Internal Revenue Code provided a limited dividend exclusion for individuals. This provision was repealed by the Tax Reform Act of 1986 as part of Congress' effort to simplify the Code. Similar provisions have existed with respect to interest and have also been repealed. Past experience appears to suggest that a limited exclusion of this type would have little impact on the savings rate. We feel that the benefits to be derived from this proposal would not justify the additional complexity that it could create.

This response is based on a preliminary analysis of the descriptions you provided in your question to me. I will be happy to answer any additional questions you may have and to update my response to reflect the details of your proposal.

RESEARCH CREDIT FOR DEVELOPMENT OF GENERIC DRUGS

Question (Senator Hatch):

My second question deals with the generic drug industry, which has been very important in reducing the costs of pharmaceuticals in this nation. Section 41 of the Internal Revenue Code provides a tax credit for qualified research expenses. Section 41(d)(4)(C) excludes research relating to the reproduction of an existing business component from the definition of "qualified research." In a recent Technical Advice Memorandum, the Internal Revenue Service (IRS) took the position that generic drugs are duplications of existing listed drugs and that the expenses of developing those drugs are consequently excluded from the definition of the term "qualified research." However, in testimony before the Subcommittee on Select Revenue Measures of the House Ways and Means Committee on October 6, 1994, on a proposal to clarify that generic drug research expenses may be eligible for the research credit, Glen Kohl, Tax Legislative Counsel of Treasury, stated that the question of whether the development of generic drugs is qualified research should be resolved on a case-by-case basis. I understand that in answer to a question, Mr. Kohl stated that there is no requirement that to qualify for the credit a product must be "new to the world." This seems to be at odds with the official IRS position that generic drugs are excluded from the definition of "qualified research." Could you please clarify the official Treasury position on this important issue?

Answer:

I believe that the statement of Glen Kohl, Tax Legislative Counsel, that a product is not required to be "new to the world" in order to qualify for the research credit is best clarified by a passage in Mr. Kohl's prepared testimony:

> "[T]he credit has never been expressly limited to research resulting in innovative products that advance the general state of technology. Such a limitation would be difficult to apply because it would put the IRS in the position of evaluating the extent of technological advancement achieved in the development of various products. Thus, the costs of developing a product that is new for a particular taxpayer can qualify for the credit even though other taxpayers already offer similar products. The only express limitation that

applies to competing products is the exclusion for products developed by duplication."

Although I cannot comment on any particular case, it is my understanding that, generally, it is this issue of duplication, and not whether the drug is "new to the world", that is central to the question of whether a particular generic drug qualifies for the research credit.

UNRELATED BUSINESS TAXABLE INCOME

Question (Senator Pressler):

Agricultural organizations qualify as tax-exempt under IRC section 501(c)(5). However, certain income of these organizations may be classified as Unrelated Business Taxable Income (UBTI) and subject to tax.

A recent IRS Technical Advice Memorandum (TAM) takes the position that associate member dues are access fees to some types of insurance and not dues at all. From that position, the TAM concludes that associate member dues of these organizations are subject to tax as UBTI. Last May, a majority of the Members of the Senate Finance Committee transmitted a letter to then Secretary Bentsen requesting further review and evaluation of the TAM in question, as it appears to reverse the IRS's long-standing position concerning the tax treatment of agricultural organizations' associate member dues. Since that time, the IRS has continued to press this new position against several other agricultural organizations.

(1) Last year's letter asked that the IRS delay enforcement of any new position until there has been a complete policy review and determination of how best to proceed in this matter. Do you agree that any change in IRS position should come only after careful review at the highest levels?

(2) Do you have any other thoughts regarding this matter that you will share with the committee? I would appreciate the benefit of your views for the record of this hearing.

Answer:

The IRS National Office issues Technical Advice Memoranda to its agents in the field in response to legal questions that arise during audits of particular taxpayers. In the course of an audit of a farm bureau that qualified as a tax-exempt agricultural organization, the IRS issued a TAM concluding that the particular farm bureau in question was subject to unrelated business income tax on the associate member dues it had collected. The Office of Tax Policy within the Treasury Department has been considering the policy issues arising from this type of situation. We have consulted with the American Farm Bureau Federation to gather more information. Consideration is also being given to the need for generalized guidance on this subject. A decision on these questions will be made at senior levels of the Treasury Department. It is anticipated that there will be a resolution of this issue by March of this year. You may be certain that your views and those of other Members who have contacted us on this issue will be kept in mind.

NAFTA/CHILE

Question:

President Clinton has said that Chile would be "an ideal partner" to join NAFTA.

a. Under what criteria will Chile be allowed to accede to NAFTA?

Answer:

President Clinton joined with his Mexican, Chilean and Canadian counterparts in announcing on December 11 the decision to begin the process of Chile's accession to NAFTA. This is the next step toward our goal of expanding market opportunities throughout the hemisphere through equitable rules and eliminating barriers to trade and investment with agreed disciplines at high levels. Chile has demonstrated its readiness to take on such disciplines now, both by its statements and its achievements.

The standards will emerge from assessment of how Chile stacks up against NAFTA disciplines. We are doing this assessment now and will consult with Congress on our negotiating objectives.

Chile has many of the characteristics that we are looking for in a NAFTA partner. It has a strong economy with excellent prospects for growth. The highly respected Davos Economic Forum recently rated Chile the fifth most competitive emerging economy. It represents a model of economic reform: consistent, prudent fiscal and monetary policies have been in place for years now, successfully reducing inflationary pressures. Chile's favorable economic outlook is further enhanced by current strong investment inflows. Foreign investment is mostly (60 percent) long-term direct investment. Exchange markets have pushed up the value of the Chilean peso against the dollar in recent years, so much so that Chile recently shifted the band in which the peso floats. Chile's financial picture is bright: manageable current account deficits (estimated at about one percent of GDP for 1994), strong foreign currency reserves, vibrant domestic financial markets providing attractive alternatives to external financing, and prudent management of short-term capital flows.

Chile has an open, dynamic trade and investment regime. Chile played a positive role in negotiating improved disciplines in the Uruguay Round Agreements, is one of the original signers, and has ratified and begun to implement them. Chile is also participating as an observer in several OECD committees.

b. Will Chile be required to agree to the side accords on labor and the environment?

Answer:

In the December 11 joint announcement by President Clinton and his Mexican, Chilean and Canadian counterparts of Chile's prospective accession to NAFTA, the leaders referred to policies that address the conditions of labor and protection of the envitonment as among the pillars of a new partnership in the Americas.

The Administration will be working closely with the Congress to determine how best to address these important issues in our evolving relationship with Chile.

Question:

What is the time-frame for beginning and completing negotiations with our NAFTA partners and with Chile on this matter?

Answer:

As directed by President Clinton and the other leaders, we began preparatory discussions shortly after the Summit of the Americas. We continue to work together with Mexico and Canada on the preparations necessary to begin formal negotiations, including focusing on relevant technical procedures and institutional issues. We intend to meet with Chile soon. Trade Ministers of the four countries will meet no later than May 31, 1995, to review this work, with full accession negotiations to begin expeditiously thereafter.

We have established no timeframe for completing negotiations. Our intention is to get the best possible agreement in terms of U.S. interests, and we believe that the best way to achieve that is to leave the timing of completion open.

Question:

In the Summit of the Americas held in Miami this past December, the 34 participating countries agreed to create by 2005 a Free Trade Area of the Americas (FTAA). Does the Administration see the negotiations with Chile as establishing a blueprint for later negotiations with other countries? When will those negotiations begin? Will they be conducted only after negotiations with Chile are complete, or will they occur simultaneously?

Answer:

Our intention in negotiating NAFTA accession with Chile is to reach an agreement that best advances U.S. interests. That is how we intend to approach each market opening agreement that we pursue. Our preferred approach at this time is to use NAFTA accession as the basis for free trade with other countries. However, we do not believe that committing ourselves to use one set of negotiations as a detailed blueprint for negotiations with other countries is the optimal way to achieve this end.

Timing for negotiations with other Western Hemisphere countries is an issue that we will have to consider as we consult with the Congress on Chile's NAFTA accession. We will want to make sure that any countries with which we wish to enter into negotiations are ready to take on the high level of disciplines to which we are committed.

Since we do not know when we will finish Chile's NAFTA accession negotiations, we cannot say whether other negotiations will begin before those end.

FAIR TRADE IN FINANCIAL SERVICES

Question (Sen. D'Amato):

The Banking Committee, which I chair, has long been interested in opening up the financial markets of Japan and other countries. To help do that the Senate has passed a Committee formulated Fair Trade in Financial Services bill on several occasions. This bill would essentially give U.S. negotiators a new tool to help open foreign financial markets by giving our government the authority to restrict market access here of financial firms from countries that deny our firms national treatment. This authority is discretionary, not mandatory. Secretary Bentsen vigorously supported enactment of that legislation. If confirmed will you continue to support its enactment?

Answer:

Treasury appreciated the support that the Chairman has given to Treasury efforts to improve access for U.S. financial services providers in foreign markets. The Administration worked closely on this issue with the Senate Banking Committee last year. There was strong and bipartisan support for the effort to pass Fair Trade in Financial Services legislation which, as you point out, did win Senate approval.

Treasury's focus for the first six months of this year is on obtaining a successful outcome to the continuing financial services negotiation in the World Trade Organization(WTO). If we take a most-favored-nation (MFN) exemption in financial services under the General Agreement on Trade in Services (GATS), Fair Trade in Financial Services legislation would provide leverage for continuing efforts to open financial markets.

Question (Sen. D'Amato):

The Wall Street Journal reported on January 9 that the U.S. and Japan are preparing to sign an agreement, in conjunction with the January 11 meeting between President Clinton and Prime Minster Murayama, that would give U.S. firms better access to Japan's financial markets. I understand that in return for the commitments being made by Japan our government would commit to continue giving Japanese firms MFN and national treatment in our market.

If the Japanese fail to live up to their commitments in the new agreement or if they adopt new measures to block U.S. firms from competing in their market would we be free under the proposed agreement to deny them national treatment and MFN?

Answer:

Yes, we would. Our commitment to continue giving Japanese firms MFN and national treatment in our market is conditional on Japan's implementation of the agreement. The Agreement includes a consultation process and a section on assessment of implementation of the Measures that will enable us to monitor whether or not the Measures are being implemented, and gives us the ability to raise new issues should new problems emerge.

Question (Sen. D'Amato):

One aspect of the proposed financial services agreement with Japan would allow U.S. firms to compete for a greater share of Japan's private pension fund market. Under the proposed agreement, over time U.S. firms would be able to compete for 100 percent of that market, rather than the 30 percent they are presently restricted to. Is there a specific time frame for reaching 100 percent access? If not, don't you think that should be spelled out in the agreement to avoid future problems?

Answer:

No, there is no specific timeframe in the agreement. In the Employee Pension Fund segment of Japan's corporate pension fund market, the Japanese have committed to further improve access of investment advisory companies through the gradual enlargement of the current one-third ceiling on discretionary fund management of Employee Pension Fund accounts (the so-called "one-third rule"). Japan has also made a separate commitment in the Employee Pension Area which will immediately free up an additional $50 billion in Employee Pension Fund money.

We will monitor the enlargement of access to the corporate pension fund market very carefully to see that it comes about.

Question (Sen. D'Amato):

Still another issue with regard to the proposed agreement with Japan concerns public pension funds. Under the proposed agreement, U.S. firms would have to manage such funds in partnership with Japanese trust banks. What if Japanese trust banks will not cooperate with U.S. fund managers? Does the Japanese fund have a right to hire a U.S. firm even if a Japanese trust bank will not cooperate?

Answer:

The Japanese have committed to make the Nempuku scheme a viable mechanism in practice for allowing investment advisory companies to participate in the management of public pension funds. We are satisfied with that commitment, but we will be watching implementation of the scheme carefully.

The best protection we have to ensure that the Japanese commitment on public pension fund management benefits U.S. fund managers is that Japanese fund sponsors supported our objectives in the Framework financial services negotiations. They wanted, and now have, the ability to hire specialized managers so they can improve fund management performance in Japan.

FINANCIAL SERVICES DEREGULATION

Question (Sen. D'Amato):

The laws governing the financial services industry are antiquated. Last year, in the interstate banking bill, Congress directed Treasury to conduct a study of the nations financial services system and make recommendations to Congress. I am very interested in this subject.

1. Is the Study underway? What is the status?

2. Are you familiar with the Treasury Study forwarded to Congress in 1991, entitled "Modernizing the Financial System: Recommendation for Safer, More Competitive Banks"? Its recommendations are similar to the key principles of bills I have introduced (in 1987, 1989) to modernize the financial system on a comprehensive basis.

- Will Treasury's new study proceed on the assumption that the findings and recommendations of the 1991 study are still valid?

Answer:

The interstate banking legislation directs the Treasury to conduct a study on the financial services system after consulting with an advisory commission and nine federal agencies. We will soon make decisions on the members of the Advisory Commission on Financial Services, and we expect that the Advisory Commission's first agenda item will be to discuss the direction we have set for the study.

As we proceed with the study, we will carefully review the findings and recommendations of the 1991 study. As you know, the new study's focus on the users of the system during the next ten years is different from that of the 1991 study. In addition, the financial services study will have a broader scope than the 1991 study (all financial services and not just depository institutions) and consider some issues not addressed in the 1991 study, such as technological developments.

WHITE HOUSE SECURITY

Question (Sen. Pressler):

Following the recent shooting at the White House, what are your views regarding the need for increased security on Pennsylvania Avenue? Do you believe Pennsylvania Avenue should be closed to the general public?

Answer:

As the President has said, the White House is the "people's house." It is also the place where he works and where he and his family live. Obviously, we have to find the appropriate balance between access and protection. The Department's review of White House Security will be completed by the end of February. It would be premature of me to state any position before I have had a chance to review that report.

REINVENTING GOVERNMENT

Question (Sen. Pressler):

The Treasury Secretary, in addition to policing the economy, also is responsible for a variety of law enforcement functions. The heads of the Secret Service, the Customs Service, the Bureau of Alcohol, Tobacco and Firearms, and the Federal Law Enforcement Training Center all report to the Secretary of the Treasury. In an era of reinventing government, of streamlining and downsizing the federal bureaucracy, some have suggested that several, or all, of these law enforcement agencies might better fit under the Department of Justice. Having served in the military during the Vietnam War, I understand very well, the strong interagency rivalries, jealousies, and in-fighting which sometimes occurs among branches with similar missions. So I understand that you are not likely to give up any of these agencies without a fight. But do you see any merit to the argument that Customs Service personnel working beside personnel from INS at the same port of entry should report to the same Cabinet secretary?

Answer:

Your objective and mine is to reinvent government. Last Friday (Jan. 13) the Departments of Treasury, Justice, Customs, the National Guard, and the Border Patrol announced a joint specialized drug enforcement operation in and around Calexico. Customs and INS are embarked on an ambitious port quality improvement program, involving shared automated data bases, cross-training, and scheduling. Reinventing government is all about these types of efforts and I am committed to them.

You mention downsizing and streamlining as two goals of reinventing government. I don't think our border efforts are a place for downsizing. Both Customs and INS have recently moved additional people to the Southwest border. This is critically important.

I don't believe that Customs Service personnel would operate more effectively outside of Treasury. Customs is, after the Internal Revenue Service, the largest collector of revenues for the federal government. It would be inappropriate from an organizational standpoint to have this major revenue collection function outside the Treasury Department. Moreover, Customs has been safeguarding U.S. borders since 1789. Its inspectors, agents, and staff enforce over 500 laws at the border and promulgate regulations under numerous trade laws. Treasury and Customs worked with the Administration in NAFTA and GATT negotiations, and are responsible for formulating implementing regulations under these treaties. Border protection and trade enforcement and revenue collection are integral to Treasury's economic management. Customs is a leading example of reinventing government -- responsive customer service, efficient automation, local partnerships, and innovative compliance measurement. From the White House to Wall Street to Capitol Hill, Treasury employees have earned the respect of the financial and enforcement communities. At this juncture, I fail to see any merit in having the Customs Service with its integrated border, trade, and revenue functions report to the Attorney General.

Question (Sen. Pressler):

What is your response to the proposal that the Bureau of Alcohol, Tobacco and Firearms (BATF) should fall under the control of the Attorney General as the FBI does?

Answer:

I believe that it is necessary to retain a check and balance against consolidation of national police power in one federal agency. Consolidation would also risk diluting the focus that is given to firearms, violent criminals, explosives and arson by the ATF.

ATF is unique in that it has both regulatory and criminal jurisdiction over firearms, arson, explosives, and alcohol. Having regulatory authority, in addition to criminal investigation powers, gives ATF the ability and specialized knowledge to correct weaknesses that make the system vulnerable to crime. These prevention programs are very effective. By combining prevention and detection programs with criminal investigations and prosecutions, ATF can implement an integrated, efficient enforcement strategy. Transferring ATF's criminal investigation power to the Attorney General would lose this integration and efficiency.

In contrast, the Attorney General and her enforcement bureaus have only criminal investigation authority. They must police a broader spectrum of conduct. Their priorities necessarily shift more widely than ATF's priorities, which are closely related to the core mission of ATF. ATF works closely with and provides extensive assistance to federal, state and local law enforcement.

Between 1990 and 1994, ATF's 1,500 agents opened 71,312 investigations and produced 33,694 cases for prosecution. Over 74% of these suspects are repeat criminals with prior arrest records and 90% involve violations of Federal firearms statutes. Within this total are 12,126 arson and explosives cases with over 4,000 defendants forwarded for prosecution. ATF's expertise is strengthened by their close working relationship with both private industry and state and local police officials, with over 40% of ATF's cases involving joint investigations with state and local police or fire officials. The tight focus of ATF and those close working relationships allow ATF to be extraordinarily effective in investigations such as the World Trade Center bombing and the recent abortion clinic shootings in Massachusetts. In both cases, ATF had identified suspects within hours of arriving on the scene.

Finally, ATF has substantial revenue collection responsibilities and raises over $13.9 billion a year from excise taxes on alcohol, firearms, ammunition and explosives. The Department of Justice has no such responsibilities and the cost of establishing an infrastructure capable of accomplishing that function in Justice would be substantial. From all reports that I have received the cooperation and coordination between ATF and the FBI could not be better. The complementary nature of their responsibilities has served this government well.

Healthy competition in Federal law enforcement between the Departments of Treasury and Justice historically, has been valued as the primary means for avoiding a single national Federal police force and the threat such a consolidation of power could represent to the Constitution.

O