

**TAX CUT PROPOSALS IN THE PRESIDENT'S FISCAL  
YEAR 1996 BUDGET AND IN THE CONTRACT  
WITH AMERICA**

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**HEARING**  
BEFORE THE  
**COMMITTEE ON FINANCE**  
**UNITED STATES SENATE**  
**ONE HUNDRED FOURTH CONGRESS**

**FIRST SESSION**

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**FEBRUARY 8, 1995**  
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# CONTENTS

## OPENING STATEMENTS

|   | Page |
|---|------|
| Packwood, Hon. Bob, a U.S. Senator from Oregon .....              | 1    |
| Moynihan, Hon. Daniel Patrick, a U.S. Senator from New York ..... | 2    |
| Baucus, Hon. Max, a U.S. Senator from Montana .....               | 2    |
| Chafee, Hon. John H., a U.S. Senator from Rhode Island .....      | 3    |
| Conrad, Hon. Kent, a U.S. Senator from North Dakota .....         | 3    |
| Breaux, Hon. John B., a U.S. Senator from Louisiana .....         | 4    |

## ADMINISTRATION WITNESSES

|  |   |
|--|---|
| Rubin, Hon. Robert E., Secretary of the Treasury ..... | 5 |
|--|---|

## ALPHABETICAL LISTING AND APPENDIX MATERIAL SUBMITTED

|                                |    |
|--------------------------------|----|
| Baucus, Hon. Max:              |    |
| Opening statement .....        | 2  |
| Breaux, Hon. John B.:          |    |
| Opening statement .....        | 4  |
| Chafee, Hon. John H.:          |    |
| Opening statement .....        | 3  |
| Conrad, Hon. Kent:             |    |
| Opening statement .....        | 3  |
| Moynihan, Hon. Daniel Patrick: |    |
| Opening statement .....        | 2  |
| Packwood, Hon. Bob:            |    |
| Opening statement .....        | 1  |
| Rubin, Hon. Robert E.:         |    |
| Testimony .....                | 5  |
| Prepared statement .....       | 45 |

## COMMUNICATIONS

|                                       |    |
|---------------------------------------|----|
| Telephone and Data Systems, Inc. .... | 54 |
|---------------------------------------|----|

# **TAX CUT PROPOSALS IN THE PRESIDENT'S FISCAL YEAR 1996 BUDGET AND IN THE CONTRACT WITH AMERICA**

**WEDNESDAY, FEBRUARY 8, 1995**

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

The hearing was convened, pursuant to recess, at 9:30 a.m., in room SD-215, Dirksen Senate Office Building, Hon. Bob Packwood (chairman of the committee) presiding.

Also present: Senators Chafee, Grassley, Simpson, Murkowski, Nickles, Moynihan, Baucus, Pryor, Rockefeller, Breaux, Conrad, Graham, and Moseley-Braun.

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

The CHAIRMAN. Good morning, Mr. Secretary.

Secretary RUBIN. Good morning, Mr. Chairman.

The CHAIRMAN. Did you have any rules for your annual pummeling?

You know, as you drive in these newer cars, and you look over at that mirror on the right-hand side, and it says, "Objects in the mirror are closer than they appear." That is how I feel about the deficit. It is tailgating us, and we all know it is tailgating us. Sooner or later, it is going to rear end us. And, apparently, we are not going to do anything about it in this first year of this Congress.

And I am disappointed. I am disappointed in the administration. I am disappointed in Republicans and Democrats in Congress, because I do not think we have the heart to face up to the problem that we all know is the problem. The President has said Social Security is off the table. Republicans and Democrats have said Social Security is off the table. Medicare is apparently off the table. Interest has to be off the table.

And we talk about a deficit baseline of \$200 to \$400 billion for the unforeseeable future. And, if we say that the major items are off the table, but we are going to solve it by cutting back on the paper clips and pencils, we all know that we are fooling ourselves.

I am disappointed if a balanced budget amendment does not pass, not because I know if it works or not, or if it is enforceable or not, but I feel that, without that hammer, we will not have the heart to ever start down the road that every one of us in this Committee and Ways and Means, and the administration, and I think, Mr. Secretary, in your shop knows is necessary.

So, with that jolly admonition, I will turn it over to Senator Moynihan.

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

Senator MOYNIHAN. Well, thank you, Mr. Chairman.

Just in a spirit of debate, can I point to the Secretary's chart, which shows that in 1992 the deficit was almost 5 percent of gross domestic product. And in 1993, we enacted a deficit reduction package on our own, without any Constitution so decreed. Probably, if the Constitution had so decreed, we could not have done it because we could not have agreed on what the numbers were.

But we had a package of \$500 billion in reduction. In any event the decline in interest rates, and some other things associated with our passage, produced—and I think the Secretary would agree—about \$625 billion in deficit reduction. And we got down to 3 percent and on our way to 2 percent of the deficit as a share of gross domestic product.

That is a pretty dramatic drop there. And it argues that, if we have the will, we can do this. We had the will. It was not easy. The Chairman will not mind if I say that it was something we had to do on our own. But it was done once and it could be done a second time.

I guess I would want to hear from the Secretary later why, having put us through that exercise and aroused our self-confidence to a degree which we had not had, and perhaps had not deserved, you now abandon us and give up on the exercise. Perhaps you have not, and I am sure you will have something to say about it.

We welcome you, Mr. Secretary.

The CHAIRMAN. Senator Baucus.

**OPENING STATEMENT OF HON. MAX BAUCUS, A U.S. SENATOR  
FROM MONTANA**

Senator BAUCUS. Thank you, Mr. Chairman.

Mr. Chairman, I just want to make a very brief observation which is very similar to yours, namely that we have not done enough to reduce the deficit. I understand some of the reasons why the administration proposed the budget that it did. That is why it did not cut spending as much as it otherwise might. Some of them were public policy; others were a little bit political.

It was not a budget submission which, I think, goes in the direction that more Americans want to go toward, namely, getting our budget under better control. Even though nobody has stepped up to the bat yet, either on Pennsylvania Avenue or either side of Capitol Hill, most Americans want more in deficit reduction.

And that is going to mean, if we also have tax provisions, and I think middle-income Americans—and I intentionally use the word "middle-income"—deserve some kind of a break some way, whatever it is worth.

For example, in my State of Montana, the increase of wages for non-supervisory employees rose 2.7 percent over the past couple of years, which is almost exactly the same as the rate of inflation for that same group. They need some help. But, if we are going to help them, obviously we have to cut even more spending.

And I just urge all of us to keep on the ball here. It very well might mean we have to have a balanced budget Constitutional amendment to make that happen. I am undecided on that point but, the longer I am around here, the more I am pushed in that direction. And I hope that we can just get the job done without it.

The CHAIRMAN. Senator Chafee.

**OPENING STATEMENT OF HON. JOHN H. CHAFEE, A U.S.  
SENATOR FROM RHODE ISLAND**

Senator CHAFEE. Thank you, Mr. Chairman. I find the administration's proposals fantasy. I cannot understand why, when we are running these terrible deficits, we have a nice smorgasbord of tax cuts before us.

And are they going to do things, such as encourage education? Sure, but the real problem, as we heard in testimony from the Chairman of the Federal Reserve, is artificially high interest rates and if we want to get interest rates down, the best way we could do that is to cut the deficit.

Also, I see that these goodies you have strewn before us, like special IRA's, do not cost much now but in the out-years, they are tremendously expensive. And we know this because we have looked at these in the past.

So, Mr. Chairman, I am unenthusiastic about these tax cuts. The real problem is what we are doing to our children, our grandchildren, and this nation. We are living in a wonderful style, and just sending them the bill. And at some point we have got to stop.

All these goodies he has got here, childrens' tax credit, education, job training tax deduction, expanded deductible IRA's, special IRA's, they are all lovely, but they all add to our deficit and require greater taxation and further cuts in order to accommodate them.

I believe every cut we make this year should go toward deficit reduction. So I am unenthusiastic about the proposals that Secretary Rubin and the administration have submitted.

The CHAIRMAN. Senator Conrad.

**OPENING STATEMENT OF HON. KENT CONRAD, A U.S.  
SENATOR FROM NORTH DAKOTA**

Senator CONRAD. Well, maybe I can add some partisan flavor. I am disappointed with what the Republican Contract with America calls for because it calls for about five times as many tax cuts as the Administration's proposal, most of them targeted at the wealthiest among us.

And, if there is any problem with the administration's tax cut proposal for middle-class Americans, you can see it pales with the Republican proposal, which is targeted at the wealthiest among us, and is a much bigger tax cut.

Just to put things in perspective, the fact is that this administration reduced the deficit. It is the first one since I have been here that actually did something significant. And I remember we did it without a single vote on the Republican side, not one.

When the President came in, the deficit was about 5 percent of gross domestic product. It was \$290 billion. That has been reduced to 2½ percent of GDP, or cut in half, and the deficit this year is about \$176 billion. That is real progress. And it happened because

the President had the courage to step up to the plate and offer a plan that gave us that result.

With that said, more needs to be done. I am one who has not made a final judgment on the balanced budget amendment. I have favored a balanced budget amendment in the past, if it was properly crafted. And by properly crafted, I mean one that does not use the Social Security trust fund to balance the budget, one that has a capital budget, as 42 States do which have a balanced budget requirement.

That makes some economic sense to me. I am not certain at all that the balanced budget amendment we are going to vote on is going to make sense. I am very concerned about that.

But I am also concerned that we are not making more aggressive progress in moving towards a balanced budget. That is critically important, I think, for economic reasons, the most important being to keep interest rates down so that this economic expansion can continue. And I hope that is the focus of our efforts in this Congress.

I thank the Chairman.

The CHAIRMAN. Senator Breaux,

**OPENING STATEMENT OF HON. JOHN B. BREAU, A U.S.  
SENATOR FROM LOUISIANA**

Senator BREAU. Thank you, Mr. Chairman. How come the cameras are all on that side? [Laughter.]

Times have changed. An election was held.

I heard Senator Chafee, my good friend and colleague, objecting to the Roth-Breaux IRA proposal. I would just remind him that I am just following his colleague, Bill Roth, in proposing it. It is a Republican proposal, and I think it is a great proposal. The Roth-Breaux IRA proposal is a great idea, but it is a Republican idea.

In this Congress, I am just the second sponsor and, not the lead sponsor of the legislation. I think it is something that needs to be done to increase savings in this country, which is so low as compared to other industrialized nations.

Any budget proposal of any President is controversial, and it should be. It is a starting point; it is not the end, it is the beginning of the process. And, if somebody has better ideas on how to reduce the deficit, let us hear now and we will debate them. Maybe tax cuts are not a good idea. I think the President is correct in suggesting that the middle-income people, who are struggling in this country, have gotten the raw end of every deal in the last decade, and they need some help.

Individual Retirement Accounts for middle-income people will help. More disposable income through a tax cut helps people who work, and we should make work more attractive. I think the best social program we can pass in the Congress is a good job and good income for middle-income people.

I think the President's budget is a good starting point. I like some of the things that are in it. A lot of programs are being terminated on the Federal level. A lot of Federal programs are being consolidated, and I do not know anybody who objects to that. I think that they are pretty good ideas if we do them properly.

A final point is that my colleague, Senator Conrad, mentioned a balanced budget amendment now being considered on the Senate floor. You talk about a lack of specificity. We are talking about balancing the budget by 2002 without cutting defense, without touching Social Security, and without increasing taxes. I suggest that there must be a secret plan somewhere in Washington, Mr. Secretary, that those proposing the balanced budget must have. And I think the American people ought to see it.

Does it slash Social Security? Does it cut Medicare? Does it eliminate highway programs in the States? I would like to see what the secret plan really says about how we are going to get there by the year 2002. It must be a hell of a plan if we are going to do that without touching any of these programs. I would just like to see it.

And, at least, you have something for us to see. It may not be perfect, but I think it is a good starting point.

The Chairman. It is interesting—a secret plan to end the deficit. It has a certain resonance to it.

Senator BAUCUS. The same credibility too. [Laughter.]

The CHAIRMAN. Mr. Secretary.

#### **OPENING STATEMENT OF HON. ROBERT E. RUBIN, SECRETARY OF THE TREASURY**

Secretary RUBIN. Mr. Chairman, thank you. Thank you, Senators.

What I will do in my oral comments is to present the budget and, hopefully, present the philosophy that underlies the budget. And I think that philosophy is responsive to a lot of the issues that you have raised. Then, afterwards, we can get into the specifics, as you see fit.

Chairman Packwood, Senator Moynihan, Members of the Committee, I am very pleased to be here to present the budget for fiscal year 1996. It is a budget in its broadest sense that continues a process of cutting the deficit begun at the start of this administration. And it cuts taxes and increases public investment, both in ways designed to increase future productivity.

What I would like to do now, as I said a moment ago, is to summarize a longer statement that I have submitted for the record.

President Clinton, from the very beginning of this administration, has had a broad-based economic strategy designed to generate and then protect the recovery, to put the country on the right track for the long term. That is to say, to position us economically for the long term, and to increase the incomes of working Americans.

This strategy consists of fiscal discipline, private and public investment to increase long-run productivity, opening markets, reforming Government and reforming regulation, and achieving health care and welfare reform.

The threshold issue that we faced was the very one that you have discussed already this morning, which was the deficit—to bring the deficit under control after a long period of large and increasing deficits and, at the beginning of the administration, facing projections for large and increasing deficits going forward, inherited from the prior administration.



Working with Congress, we enacted a powerful deficit reduction program. As a result, the deficit has come down from \$290 billion in 1992 to what we now project as \$193 billion for this year.

Or, to use a starker contrast, and one that I think makes the point more clearly, the deficit comes down from a projected \$400 billion in 1998 had the deficit reduction package not been enacted to \$196 billion projected for the same year, 1998, under this budget.

The deficit as a percentage of GDP, as Senator Moynihan pointed out, goes from 4.9 percent in 1992 to a projected 2.7 percent this year, chart 1, and a projected 2.1 of GDP in the year 2000. As the budget book shows, although it is not on our chart, to a projected 1.6 percent in the year 2005.

Fiscal discipline has been reestablished after a long period of ballooning deficits. The deficit has been reduced by more than one-half as a percentage of GDP.

I worked in the financial markets for 26 years, and I have absolutely no doubt that the aggressive deficit reduction program just described was in very large measure responsible for the decline of interest rates in 1993 which, in turn, was a key factor in jump starting the economy in that same year.

Rates have now increased again, but that increase reflects growth. The deficit premium, which was the key impediment to growth on the interest rate side prior to this administration, is in very large measure—not totally, but in very large measure in my judgment—now out of long-term interest rates.

We now have a strong investment-led recovery that is creating jobs. Business investment in machinery and equipment—this is our second chart—has increased dramatically. As a percentage of GDP, gross domestic product, the equipment spending is at an all-time high. That is an enormous plus for future productivity.

The economy has created 5.7 million new jobs, with over 90 percent in the private sector. The unemployment rate has declined from 7.1 percent to 5.7 percent. Even with the strength of the current recovery, the increase in the consumer price index has come in under 3 percent for each of the last 3 years.

Maintaining low inflation is a very high priority of this administration.

In the long term, however, the success of our economy will depend on raising productivity growth. Productivity growth has been extremely slow for a generation, and this has contributed to slow growth in workers' incomes.

Senator Baucus pointed out that slow growth in average wages has been accompanied by an unequal distribution of income gains. In the past 15 years, those with incomes in the lowest fifth of American households have seen their real incomes fall. Those in the top fifth have seen their incomes rise, and the middle has stood still.

This budget emphasizes a three-part strategy to promote growth and improve the incomes of working Americans: One, maintaining fiscal discipline; two, providing tax relief for the middle class in a manner targeted to also promote individual activity so as to increase future productivity and; three, increasing public investment in workers through education and training.

Let me first address fiscal discipline. On a 10-year basis, as I mentioned a moment ago, the deficit is projected to decrease to 1.6 percent of GDP. We continue reducing the deficit while lowering taxes at the same time by making substantial spending cuts in three areas. And we put forth specifics with respect to all of our spending cuts.

Restructuring Government saves \$26 billion, savings that come largely from five agencies—Transportation, Energy, Housing and Urban Development, General Services Administration and the Office of Personnel Management.

We save \$80 billion by further lowering the discretionary caps in 1996 through 1998 and extending the discretionary caps for 2 years beyond their scheduled expiration in 1998.

Thirty-two billion dollars in savings comes primarily from the mandatory side of the budget, through continuing some existing health care savings and various other items.

The remaining \$5 billion of deficit reduction comes primarily from lower debt service, which in turn is a result of our success in lowering the deficit. All of these program cuts added together total \$144 billion between 1996 and the year 2000.

The President has proposed using \$63 billion of these savings to provide tax relief to middle-income families as part of his Middle Class Bill of Rights.

While the deficit is projected to continue to fall as a percentage of the economy for the next 10 years, we agree with the sentiments expressed by most of you that more must be done.

Eventually the deficit will turn up. The problems, as you well know, are an aging population and rapidly rising health care costs. It has been the President's view from the beginning of this administration, and remains his view today, that if we want to maintain fiscal discipline over the long run, we must reform the health care system as soon as possible.

Before I leave our deficit reduction discussion, let me make two additional points, if I may. In the last 2 years, for the first time since the 1960's, expenditures on Government programs are less than the taxes paid by the American people. In other words, our deficit results from the burden of paying interest on the debt accumulated, primarily because of the deficits of the 1980's. That chart shows that, if it had not been for the interest on the debt, we would now have a small surplus. The vast preponderance of that debt was accumulated in the 12 years beginning in 1980.

The second general point I would like to make is that I believe, and we believe, that the way to achieve deficit reduction is through deliberate and thoughtful policy choices, taken in the context of the economic circumstances at the time those policy choices are made, not through a balanced budget amendment which, in our judgment, substantially increases macroeconomic risk in our economy and involves spending cuts that have not been specified at the time the decision on a balanced budget amendment is made.

Now let me turn to tax relief for middle-income Americans. On December 15, 1994, President Clinton announced his Middle Class Bill of Rights. A middle-class tax cut has been an explicit goal of this President from the beginning. Many working families have

lagged behind, even in the past 2 years, when growth in the economy has been brisk.

Not only do these tax cuts provide immediate relief to financially strapped middle-income families, but they also serve an important economic purpose. I think this is an extremely important point. By helping these families save and invest, they will become more productive and enjoy higher future standards of living. We have targeted tax reduction squarely at middle-income families. Chart 5 shows that 86 percent of the benefits of these proposals will go to families with incomes between \$20,000 and \$100,000. Let me briefly describe the three tax cuts in the budget.

First, the \$500 child credit for children under 13. This credit is designed to help younger families, where economic pressure tends to be greatest, to provide better child care, after school activity, and the other requisites for good child rearing. This credit would reduce the Federal income tax burden of a typical two-child family with an income of \$50,000 by almost 21 percent, once the credit is fully phased in. This is an investment in children. Clearly, children are the future of our country.

Second, a \$10,000 deduction for post-secondary education and training expenses. This deduction can be used by all members of the family, and will help middle-income families better attain the education and skills requisite to equipping them to succeed at work in a modern economy. Again, people investing in themselves.

And, third, expansion of Individual Retirement Accounts. This program, in our judgment, will substantially increase the availability of Individual Retirement Accounts by raising the income ceiling to \$100,000 for joint filers and \$70,000 for individuals.

Under the President's plan—and I think this is very important when you think about the likely impact on savings—the flexibility of the Individual Retirement Account is greatly enhanced. An individual can either deduct the amount deposited up front, or forego this deduction in favor of tax-free withdrawal of all accumulated earnings after 5 years.

Also, an individual may save for a broader range of purposes. Penalty-free withdrawals may be made at any time for specified purposes such as education, a first home, or certain medical expenses.

Finally, on the subject of taxes, one of the administration's priorities is to implement fully the Internal Revenue Service's Tax Systems Modernization plan to reduce the administrative burden on business and individuals, and to raise compliance.

Public investing for the future. The President's many-faceted public investment program, critical to future productivity, will in this budget focus on his GI Bill for America's workers, which consolidates and streamlines a patchwork of some 70 job training programs, to provide school grants to lower-income and displaced workers.

You have asked me to comment on the Contract with America. So let me do that now.

One of our primary concerns—perhaps it is our primary concern—is the potential effect of the Contract with America tax cuts on the deficit. We have prepared preliminary estimates of the tax provisions in the contract, based on the bills introduced January 4,

1995. These preliminary estimates show that the tax cuts proposed in the contract would cost \$205 billion over the period 1995 to 2000. That cost grows rapidly after the year 2000, to nearly \$120 billion per year in fiscal year 2005, raising the 1995 to 2005 revenue cost to \$725.5 billion.

We were criticized by some when these estimates were first released, but they have now been confirmed since the Joint Tax Committee estimates published on Monday were roughly the same as ours.

The contract contains no proposals to pay for these cuts, or for other provisions such as increased defense expenditures.

The contract does propose a balanced budget amendment but, for the reasons that I have already discussed, we do not consider that to be good economic policy. And I would say once again that the proposal of the balanced budget amendment does not contain with it specific proposals for expenditure reductions or tax increases necessary to achieve that balance.

Moreover, several of the proposals of the contract, particularly the indexing of depreciation deductions, the neutral cost recovery provision, and the capital gains indexing provision proposals, could create very serious tax avoidance issues.

It is our prediction that, if these provisions are enacted, there is the potential for substantial tax shelter activity. Most of this tax shelter opportunity would arise from the fact that the assets would be indexed, while the debt would not. So, in effect, what happens is that the inflation that is projected to occur will, by virtue of indexing, not be taxed. But the inflation that is embedded in interest rates will be deductible. We expect that these tax shelter opportunities will be widely marketed, and could result in substantial impacts on Federal receipts.

There are also very substantial complexities in the indexing proposals which would affect both taxpayers and the Government.

With respect to the overall budget, let me conclude by saying, as I said at the beginning of my statement, that this President has had a broad-based economic strategy to generate economic growth in this country both in the short term and the long term, and to increase the incomes of working Americans. This budget is the next step in carrying forward that strategy to raise living standards for all Americans.

A great deal has been accomplished in the past 2 years, much of it involving this Committee. Significant accomplishments have been done on a bipartisan basis, but much remains to be done.

We enormously welcome the opportunity to work with you on a bipartisan basis to continue moving forward.

Mr. Chairman, thank you.

The CHAIRMAN. Mr. Secretary, thank you.

Our order of questioning this morning is Senators Baucus, Chafee, Packwood, Moynihan, Conrad, Nickles, Breaux, and Rockefeller.

Senator BAUCUS. Thank you, Mr. Chairman.

Mr. Rubin, I would just like to ask you a more specific question regarding the R&D tax credit, which is due to expire in July of this year. As you know, that is a very important part of American tax policy, particularly to industries that are on the cutting edge of the

future. As a businessman, you know the importance of research and development of better products for the future. Could you tell me what the administration is going to do to help us extend the R&D tax credit, particularly to make it permanent?

I must say that I think it is not good tax policy for R&D tax credit and other extenders to be on again and off again. It creates such uncertainty, and does not make a lot of sense to me, frankly.

To a business person who wants to plan for the future, it would seem to make a lot more sense if we just put it in the Code and left it there.

Secretary RUBIN. Senator, we would agree, I think, with everything you have said. We support extension of the credit. We would also support making it permanent, rather than extending it for a shorter period of time. The problem is that that extension costs money. We fully support extension. Whether we would support it being permanent or extending it for a more limited period of time is a question solely of resources.

What we would like to do is work with this Committee and the Congress to find the resources. But we absolutely support the provision.

Senator BAUCUS. I just think it is important that we work together and get it done. But you and I know that it has been like a football, kicked around a lot. We all know it should be in the law. We would save ourselves a lot of trouble if we just put it in.

Secretary RUBIN. As you say, it is easy to say we will work together. This is a provision that the President has cared enormously about and, as you know, has supported very strongly. It is something we very much want to see in the law, whether on an extension basis for a limited period of time or a permanent basis, depending on resources. But it is something that we fully expect to be working with Congress on.

Senator BAUCUS. I would like your thoughts on another proposal. Congressman Archer has put forth an idea that, rather than permit qualified withdrawals from IRA's without penalty, perhaps the taxpayer should be permitted to borrow money from his IRA for qualified purposes, rather than simply withdrawing it. I would like your thoughts.

Secretary RUBIN. Well, we discussed that proposal, and I have three comments. One is that I think it does raise questions about potential abuse. You could easily see somebody getting the benefit of the deduction and then immediately loaning the money to a relative, or whatever, as a way of continuing to utilize the funds but having gotten the benefit of the deduction. So you have not done anything for national savings and, at the same time, you have had a tax deduction.

Secondly—and I think this is an extension of my first comment—there are a lot of issues with respect to how you would apply such a loan provision so as to avoid the sorts of problems I have just mentioned

Having said all that, this is something we would be perfectly willing to discuss, as long as we arrived at a result that did not undermine the national savings impact of the IRA. We are very troubled by that and, for the reason I have just said, it is not clear

to us how you implement such a proposal without undermining the savings impact of the IRA.

Senator BAUCUS. Why is the administration opposed to permitting non-working spouses to make a \$2,000 contribution to an IRA? Most other proposals allow the non-working spouse to make the contribution. I was curious why the administration does not agree.

Secretary RUBIN. Well, there are at least two reasons why we did not agree, although I think it is one of those things we should try to work out. There seem to be many people involved in this on both sides of the aisle, and in the administration, who are interested in trying to do something on IRA's, so I think there is a real basis for doing something.

In our judgment, what you want to do with the IRA to make it effective—and I think this is responsive to what a lot of the critics say about the IRA. Therefore, you want to target it to people for whom this will create an incentive for incremental savings, rather than people who are going to save money anyway and use the IRA as a way of sheltering it.

The thought with respect to non-working spouses is that you are probably talking about people in higher-income brackets. Those are people who may very well have been saving anyway. So, by creating the deduction for the non-working spouse, you are more likely to be in a position where you are creating a shelter for existing savings. I think that really was the primary reason.

A secondary reason for not extending it to non-working spouses was that we had a limited amount of money, and the question was how to apply that most effectively, in terms of increasing the savings rate. It seemed to us the most effective way was to do it in the manner we did.

Senator BAUCUS. Just a quick question, back to the tax provisions. I believe that if we are going to get good high-paying jobs for more Americans, particularly middle-income Americans, in the future, we should invest—and have to invest—much more in education, post-secondary education, vo/tech education, skills and so forth.

Just looking at two major proposals that the administration has before us—one, the \$500 tax credit for families with children under 13, and compare that with tax deductions for education expenses. It is obviously very important for people with young children to have the wherewithal to raise a family and support their children. But I am wondering if perhaps there should be greater incentive for education. It is one thing to help support families who have more children. It might also be something else to encourage people to pursue higher, more meaningful, and better education opportunities, particularly if we are going to invest. I wonder if you could comment, please, on the relative importance of those two proposals.

Secretary RUBIN. It is an important question. When the budget was put together, we had long discussions among ourselves, and then with the President, on that issue. The judgment that we reached was that it was important to pursue both objectives, and this was the balance that we decided on.

On the one hand, because of the enormous pressure that has been on middle-class incomes over the past 10 or 15 years, it was our view that middle-class families with children did need some

help. They could have better child care and, as I mentioned in my testimony, some of the other things that would be useful.

On the other hand, we also felt that an education and training tax credit was right. So we struck the balance we did. Somebody else might strike a different balance.

Senator BAUCUS. Thank you. Thank you, Mr. Chairman.

The CHAIRMAN. Senator Chafee.

Senator CHAFEE. Thank you, Mr. Chairman.

Mr. Secretary, the President spoke last year a good deal about the need for health care reform. And indeed you mention it on page three, "If we want to maintain fiscal discipline over the long run, we must reform health care as soon as possible." Yet it is my understanding in this budget that nothing is done in connection with health care reform.

Why do you talk about it and not do anything?

Senator MOYNIHAN. Because of last year. [Laughter.]

Secretary RUBIN. I think that Senator Moynihan has answered in brief what I will take just an extra sentence of two to respond to. You, of course, were an enormous leader in the health care field.

The President spent 2 years, but particularly the second of his 2 years, very much in the field on health care reform, as you and everybody know. And I think it would be fair to say that it was not entirely successful. It did not succeed in Congress.

So, at the end of last year, we all sat down with the President. The question was, given that he is absolutely committed to the same vision that he articulated during the last 2 years, and believes as strongly as ever that the same problems exist, how do we best go forward? The judgment was that this time, instead of coming forward to Congress with a plan, let us try to work with Congress to see if we can develop a plan jointly.

Then the question was, do we put anything in the budget? And the thought there was, rather than have something and bring it forward to Congress, let us work with Congress and try to develop something jointly. If we put something in the budget, we would be getting out ahead of Congress. The judgment was that this was not the best way to make progress on health care.

Senator CHAFEE. So is it the administration's intention to proceed with the Congress on health care reform?

Secretary RUBIN. Senator, I can tell you without question, having been with the President a lot on this subject, that he feels that the issue is the same that he discussed for the last 2 years, but in fact is getting somewhat worse, particularly on the coverage side. Also, as you know, health care costs continue to increase at very rapid rates. And he is totally committed to the vision that he has articulated over the last 2 years. The only question is, what is the best way to move forward?

Senator CHAFEE. The Chairman of the Federal Reserve, Mr. Greenspan, as I mentioned in my opening statement, gave what I considered very informative testimony before this committee. And the thrust of his testimony, at least in answer to questions, was that if you bring down the deficit, you bring down the interest rates. And, if you bring down the interest rates, you bring down the deficit. So it is a two-fer.

I admit that you cannot keep going forever on that. Nonetheless, it works the other way around. If the markets see that the debt is not going to come down, then the interest rates go up, which makes the debt go up.

Now, do you subscribe to that?

Secretary RUBIN. I think there is no question that, as you get your fiscal house in order—all other things being equal, which they never are—interest rates will come down. That, I believe, is what we did in 1993. And I believe without question, as I said in my testimony, that was the primary factor in the recovery in 1993.

And I might add, it is part of, but not the only reason why we have put ourselves on the track we are on. What you need to do is look at the deficit as a percentage of the economy, just as you would in a private enterprise. Or, looking at any other country, we obviously can afford to have a larger deficit than Switzerland can have because we have a larger GDP.

So the answer to the question is, all other things being equal, yes. As you bring the deficit down, interest rates should come down.

Senator CHAFEE. Let me switch a little bit here. We had—

Secretary RUBIN. Could I just add one thing?

Senator CHAFEE. Go ahead.

Secretary RUBIN. Now, for example, even though the deficit is coming down, it is really a much more complicated picture than the comments we have just had.

I think what is going on is something different. Even though the deficit is coming down right now, and the deficit to GDP ratio is coming down, and I think we are generally perceived as having our fiscal house in order, there is a lot of work left to do. Interest rates have come back up. Well, they have come back up to reflect growth, which is the way you would expect the system should work.

I think the key to what happened in 1993—and I think it really is a very important thing going forward—is that prior to that time, because there was such skepticism about the likelihood that we would get our fiscal house in order, long-term rates contained what I think was a deficit premium. And I think that deficit premium has been largely squeezed out of long-term rates. And I think that is really the critical thing that has happened.

Senator CHAFEE. So you think further reduction in the deficit will not produce further reductions in the interest rates?

Secretary RUBIN. No. I think, all other things being equal, deficit reduction will decrease interest rates. Now whether the decrease in interest rates will generate more growth than the negative macroeconomic impacts, and actually bring the deficit down, I do not know. But, having said all that, we agree with you. We think the deficit needs to come down, both in absolute terms and in its percentage of gross domestic product.

We think we have put ourselves on a path to get it down as a percentage of gross domestic product. And we think that our budget, combined with health care reform, would bring it down in absolute terms.

Senator CHAFEE. Let me ask you one quick final question.



I noted that, when you discuss the IRA's, you do not discuss them in terms of increasing national savings. You talk of them as being an assist to the person who invests in them.

The testimony we had over the past several days was that it is unclear as to whether IRA's actually increase savings. To the person just observing it, it seems they are. But that is not what the experts told us.

Secretary RUBIN. Well, let me respond to that, if I may, Senator. If I created the impression that you just expressed, then I was misspeaking.

No. We are trying to deal with what I think is a serious problem—our National savings rate. There is a lot of controversy about IRA's. So what we did was to try to focus in on an IRA that we thought was targeted in such a way—that is to say to middle-income taxpayers—that it could not be used as a tax shelter. We thought that would avoid part of the criticism.

And, secondly, and very importantly, we made it more flexible as a savings instrument, with a view that that would create incentives to use it more. And the more incentive there is to use it, the more the financial services industry would promote it through advertising, and the more it would get used.

So, in its current form, it has a realistic chance. I would say more than a realistic chance. I think there is a very good chance that this could actually have an effect on the national savings rate, and it is very well worth trying.

Senator CHAFEE. Thank you, Mr. Chairman.

[Pause.]

Senator MOYNIHAN. Now if you could make decisions like that!

Secretary RUBIN. Senator, we would have a meeting.

The CHAIRMAN. Mr. Secretary, whether these IRA's work or not I do not know. I have heard the evidence on both sides. Four economists were before us last week with identical evidence, and they come down like this. Do they work? Do they not work? They do not work enough to make a significant dent in the national savings rate. Whether they work or not, they do not make any great difference, any great mega-savings and investment.

When you had your confirmation hearing, we asked you about savings and investment, Nunn-Domenici, flat tax, VAT's or whatever. Without specifically endorsing any of them, you said yes, we ought to be moving in that direction.

There is nothing in the President's plan, there is next to nothing in the Contract with America, that moves us in that direction. We ought to be building on rock, but we are building on Jello. We are not going to get there. And neither one of us, Republicans or Democrats, are willing to go forward.

I was struck with something Lady Thatcher said yesterday when she spoke to the Republican Policy Committee. Somebody asked her about Bosnia, and you know her views about Bosnia. The question was phrased that there does not seem to be any consensus in Europe about it. And she just bristled and said, "Consensus is the negation of leadership." And she is right.

The Republicans got burned in 1982 on Social Security. We made a modest suggestion, David Stockman did, for changing the eligibility to age 62, and we just got pummeled. I remember a cartoon

at the end of the election. It showed him taking his mother home. His mother was Social Security in the cartoon. And it said, "Well, goodbye, Ma. I'll see you again in 2 years when we need you once more." And we have been afraid of it ever since.

And then in 1984, Vice President Mondale, in his famous speech, talked about taxes. And he said, referring to President Reagan, "The President will have a secret plan to raise taxes, and I am telling you I have one, and he will not tell you." And President Reagan says, "There he goes again." And ever since then, with few exceptions, the Democrats have been afraid of taxes.

I understand the history. But we are not going to get there with your plan, or with the Contract with America plan. We are not going to get there on savings and investment.

Tell me, apart from this IRA proposal, backloaded, which loses a pot full of money in the out years, where in your plan, or in the Contract with America, is any significant move towards saving and investment?

Secretary RUBIN. Well, I do not want to be defending the Contract with America, if that was your question. [Laughter.]

Let me start with the Contract with America, since you raised it. I think the Contract with America has an insuperable burden in its tax cuts. And probably that is beginning to be troubling to some of its proponents. That is my impression just from reading the press.

The CHAIRMAN. The only difference is their tax cuts are bigger than your tax cuts.

Secretary RUBIN. Well, with all due respect, Mr. Chairman, I think there are several differences. One is that theirs costs \$725 billion by our number and \$704 billion, or something, by the Joint Tax Committee over 10 years. And ours, I think, costs about \$170 billion, or some number like that. So there is quite a big difference between \$170 billion and \$725 billion, or whatever that number turns out to be. That is an enormous difference.

Secondly, we have put forth a plan to pay for our tax cuts. And you might think we should do more. Or you might think that we should not have our tax cuts. And I think that is a very legitimate and good policy debate, which we should have. But the fact is that we put forward a budget that increases the national savings rate by getting the deficit down as a percentage of GDP.

I do think that we should go beyond the plan that we put forth. I should not say that I do—we do. If we enact health care reform, we can get the deficit as a percentage of GDP down even further. Then, once you get past that, you have the question of, once you have got the deficit down, what do you do about increasing savings? And the proposal we put forth is the IRA.

On the question of the IRA, what you say is true, that you get mixed evidence. Most academics tend to be rather skeptical. Having said that, and having talked to a few bankers about it, who I think probably were speaking with a reasonable degree of honesty as we discussed it—

Senator MOYNIHAN. Reasonable for a banker.

Secretary RUBIN. Well, there may be different standards. And there might even be different standards between commercial bankers and investment bankers. [Laughter.]

But leaving that issue aside, I came away at least persuaded that the IRA, in the form that we were presenting it, was worth trying. No one has ever tried it with this kind of flexibility, and it might just work. Or I would go further than that. There is at least a reasonable chance, and perhaps a fairly good chance, that it will work.

On the question you were raising of Nunn-Domenici or—

The CHAIRMAN. Well, yes. Nunn-Domenici or value-added taxes, or flat taxes, or anything. I think we sit on the cusp of an opportunity to move in that direction. But we are not going to move in that direction with your budget plan or with the Contract with America budget plan. Neither of them even approach it.

Secretary RUBIN. Well, let me just very briefly—and I suspect we will come back to this—I do not think the flat tax in the form I have seen it, the Armev tax plan, can work. Now we could discuss that. I think we actually did discuss that in my confirmation hearing.

On the question of Nunn-Domenici, I think it is interesting conceptually. It has a lot of the same problems inherent in it. And they do not have a full proposal. You do not know what their rate schedule is, so it is a little hard to see exactly how that is going to work.

But I think conceptually those are very interesting ideas. The problem is once you get into them, as I think we discussed at confirmation, it becomes a lot less clear whether they are going to be effective or not.

The CHAIRMAN. During your confirmation hearing, you said you had been on all sides of the capital gains tax. What particular side are you on at the moment? [Laughter.]

Secretary RUBIN. Oh, I think I framed it a little differently. I think my views have actually been consistent over at least the last 10 years that I have been thinking about it.

I think what I did was to set forth some criteria. I said that the capital gains tax cut in the Contract with America, in my judgment, and also our judgment, does not satisfy those criteria.

Then I said that the capital gains tax cut that the President proposed, and you all enacted in 1993, which is carefully targeted, did meet those criteria. And beyond that, we just have to look at anything that people bring us, and see how it compares to the criteria that we have.

The CHAIRMAN. Senator Moynihan.

Senator MOYNIHAN. Thank you, Mr. Chairman.

May I say to the Secretary how much we appreciate your candor and the information you bring. It is a marvel of concision and clarity.

You probably have sensed a certain disinclination towards more tax cuts. The Chairman just spoke on this. I would just generally like to associate myself with what he said.

But if I can turn to what seems to be a much larger and more pressing issue, we are debating in the Senate a profoundly important change in the basic law of the land, the Constitution. And I think you said that you did not think a balanced budget amendment would be good economic policy. But surely the question at hand would be, is it good Constitutional policy?

I thank your associate for putting that chart up once again. I think you would agree, or at least I will state, that from the beginning of the 1960's, following the recession of 1958, and the recovery which lasted only 2 years, and unemployment rose to 6.7 percent in the year President Kennedy came to office, the second highest it had been in the post-war period—as a matter of fact, since we have begun to measure unemployment. From that time on with the Council of Economic Advisers, in their first report in 1962, right through President Nixon's budget in 1974 as prepared by George Schultz, a most eminent public man, a principal concern with the exception of one or two intervals of fiscal policy planning in our country, is that the Government kept running a surplus.

And the surplus had a depressing effect in the business cycle such that you never got to full employment because the revenues would come in and the Government would not spend them. And Walter Heller and such were thinking about how to spend money.

I remember with great pleasure that they moved up the date of the GI Bill life insurance dividend. And, when that did not have much effect, they gave us a second dividend in that same year. My own household savings rose to \$1,000, and we were able to buy a farm in upstate New York, where we still live.

But the problem was fiscal drag. Government somehow was not organized to move revenue back into circulation. Therefore, George Schultz built a deficit into President Nixon's 1974 budget. He built it in. Then things changed. We went from a debt of about \$900 billion in 1979, it quadrupled and reached in 12 years' time about \$4 trillion.

That was about the same period, 12 years, that I was talking about with respect to the Kennedy-Johnson-Nixon era. One time you had a surplus. The other time, you had a deficit. And these are periodic events, having something to do with the cycle of politics and economic theory.

But to change the Constitution, to respond to almost certainly a set of one-time events, some of them deliberate, and some of them unanticipated and perhaps unavoidable, we go back to the point where spending on Government programs is less than revenue, excepting for the interest accumulated in that 12-year period.

Well, that was a one-time event. We have been around two centuries. Should we change the Constitution in response to an almost idiosyncratic moment in our history?

Secretary RUBIN. Senator, I am not an expert on the Constitution. And I do not think I can comment from a Constitutional perspective. But I think your comments also go to the economics of a balanced budget amendment.

My testimony understated how I personally feel about it, but I think it is really a very unfortunate economic policy choice because it puts us in a straight jacket. And I do not think you want to be in a straight jacket when you deal with the large number of vicissitudes which affect the economy.

Senator MOYNIHAN. We were bringing the deficit down. In 1993 we were down to 2.9 percent. That is a very impressive thing. We said we could do it on our own.

Secretary RUBIN. Yes. My impression—and you all would be more expert in this than I am—but my impression is that the pub-

lic view with respect to deficits has changed. There is now an atmosphere in which one can make progress. In 1993, I think we dramatically changed the situation in this country with respect to fiscal order. I think we put ourselves on a very constructive path. And, as I said in my testimony, the next thing to do is health care. Continue on this path, and then have health care reform.

Senator MOYNIHAN. Thank you, Mr. Secretary.

The CHAIRMAN. Senator Conrad.

Senator CONRAD. Thank you, Mr. Chairman.

I just want to say that I have heard some of the most honest talk this morning in this Committee that I have heard this year with respect to what we confront as a country. And I want to thank the Chairman, and I thank the Ranking Member and Senator Chafee as well, for some honest talk about what we face as a Nation.

One of the things that strikes me is, I noticed this morning in the Hill paper that Senator Packwood predicted that the balanced budget amendment is dead. It may well be, and maybe it should be, given the defects of this balanced budget amendment.

But there is certainly no question in my mind that we need to move toward a balanced budget over this 7-year period. The reason I believe that is clearly the case is that when one looks ahead one sees the baby boomer generation reaching retirement age and these massive Social Security surpluses turning into massive Social Security deficits. And if we do not confront the issue now, the choices are going to be much much tougher in the future. And we are going to face some really Draconian choices.

Mr. Secretary, I ask you, if the balanced budget amendment goes down, what would be your reaction to the passage of legislation that would call on the administration and the budget committees of the House and the Senate to develop a plan to balance the budget by 2002, and to have a lay-down of those plans concurrently? Let both sides put down their plan on May 1, so that we then have a competition and a debate in this country between plans.

This partisan competition that is going on now, in which both sides hurl brickbats at each other about you did this then and so on, we can all continue that forever. We are pretty good at it. That is why a lot of us are here. Instead of that, we could get into a competition of ideas about how to reduce the deficit in a way that could win the greatest support. What would your reaction be to such a plan?

Secretary RUBIN. I think I have two somewhat conflicting reactions. So let me give them to you, if I may.

I think that having an arbitrary date of 2002 is not a good idea, at least for two reasons. One is that you would have to compress an amount of deficit reduction into a specified period—in this case, 7 years. That, I think, is too heavy a burden for that period to bear. In that case you are going to have a negative impact on economic growth. It was our judgment as we put our budget together that it was not a sound thing to do.

This chart does not go far enough, but we do get the nation's budget deficit down to under 2 percent of GDP during the 7-year period. So we have, I think, a pretty aggressive program. If we could get health care reform, the percentage of GDP that the deficit

constitutes will be even lower. But I think that having an arbitrary 2002 deadline is not a good idea for this reason.

Another reason it is not a good idea is that while we project steady growth looking forward, business cycles do occur. If you get into a business cycle between now and 2002, you want to keep the so-called automatic stabilizers in effect. In other words, if we get into a slow growth period or, even worse, a recession, and the deficit increases, you do not want to be in a position where, with a recession increasing the deficit, you have to cut expenses which will exacerbate the recession.

Senator CONRAD. Well, if I can just say, that is the beauty of a plan that I have outlined. The beauty of the plan is that you are not locked into the Constitution. If something unforeseen occurs, all bets are off.

But, based on the projections that both Democrats and Republicans are making now, it is clear we are counting on having steady growth during the period. In that scenario, what would be wrong with the competition to see who can come up with the best plan to balance the budget over that period, but not be locked into the Constitutional straight jacket so that, if a business cycle turns sour, the automatic stabilizers remain in place?

Secretary RUBIN. Well, except you would have to have a vote again in Congress. And you would be subject to all the issues of 60-vote majority. You would get into all the problems of whether or not you could do what was necessary to get back into a position in which the automatic stabilizers work.

I think my basic answer would go back to what I said before. It was our judgment that the path we are on is as powerful a path as we should take, given both the macroeconomic impacts and the tradeoffs, the things you would have to cut in order to get to the balanced budget position by 2002.

Having said that, I think I would prefer our path than the one you just outlined. I think the great virtue of what you have said is that it will force people on both sides to put the specifics on the table. Then you, and in the final analysis the American people, can make a judgment whether the specifics involved in reaching budget balance by 2002 are worth the benefits. So I think it has a great virtue in that respect. It forces people to deal with the specifics of cutting the budget.

Senator CONRAD. I thank the Chairman. I also thank Treasury Secretary Rubin for his testimony.

The CHAIRMAN. Senator Breaux.

Senator BREAUX. Bob, regarding the chart you have there, showing that the deficit has been cut in half as a share of GDP, I guess we all know that the actual deficit is going up in the out years. Under the President's leadership I think we have slowed the increase in the deficit, but we are going to see an increase in real numbers. What your chart shows, as I understand it, is that, as a percentage of gross domestic product, we have a substantial reduction in the budget deficit. The red line, the projected baseline before your package and what happens with the administration's budget package, is being compared to the gross domestic product of the country.

Now if you or I tried to explain this to the average American out there, they would say what in the world are you talking about? The deficit is going up, but you tell me it is going down. I do not understand all this. Can you try to articulate to this Committee, and to the American public, why that chart is important? The fact that the deficit has been cut in half as a share of gross domestic product, why is that really significant?

Secretary RUBIN. I think, Senator, that there are at least two ways of thinking about it that maybe would make it a little bit more understandable: One, if an individual decides to borrow \$1,000, that may well be a highly imprudent thing to do if that person has an income of \$5,000 a year, but relatively irrelevant if he has an income of \$100,000 a year.

If somebody with an income of \$100,000 a year decides for whatever reason to borrow \$1,000 a year for 10 years, it is not going to affect anything relating to that individual. If somebody with an income of \$5,000 a year makes exactly the same decision, it puts that person in an economically untenable position.

So I think if you analogize with problems facing individuals, that may be helpful.

I think that is probably the most useful way to make it accessible, but I think there is another way in which I tend to think of it. And that is, when you look at a country like Switzerland, you say that Switzerland can afford so much deficit. When you look at the United States, you say it could afford a much larger deficit because it has a much larger gross domestic product. But I think the first way, for general purposes, is probably the most useful in trying to make it more accessible.

Senator BREAUX. It is sort of like the difference between Senator Rockefeller borrowing money and me. [Laughter.]

Secretary RUBIN. Well, I cannot speak to Senator Rockefeller, but it sounds like a not unreasonable way to try to do it—[Laughter.]

Secretary RUBIN [continuing]. At least from your point of view.

Senator BREAUX. I understand it a lot clearer now. [Laughter.]

Senator PRYOR. He does not borrow money, he loans money. [Laughter.]

Senator BREAUX. Have I got a deal for him! [Laughter.]

The Joint Tax Committee has estimated that the tax cut proposals in the Contract with America would cost \$704 billion over 10 years. The administration's proposed tax cut has been scored at \$172.9 billion over 10 years.

Now we have heard from our colleagues on the Republican side, and many of our Democratic colleagues, that we should not have any kind of a tax cut at all. We should be talking about trying to reduce the deficit. The Contract with America calls for a \$704 billion tax cut at a time of huge deficits. Yours is less than that by a substantial amount.

I guess my question is, how can we even think about tax cuts at a time of running a deficit? What is the purpose?

Secretary RUBIN. Well, in a word, what we tried to do, Senator, is to present a budget that had both tax cuts and deficit reduction, both in the 5-year period and even more actually in the 10-year period.

I think it would be a terrible fiscal tragedy for this country, and I think the markets would react accordingly, if the \$704 billion program were enacted without full funding. And full funding without unusual budgetary practices, and also a deficit reduction on top of that. I think it is a Herculean task. And, so far, we have not seen how that is going to be done. When you see how it is going to be done, you can make a judgment whether you think that is a sensible set of cuts or not.

As I discussed in my testimony, the reason that we combined both tax cuts and deficit reduction is that we felt they were very important public purposes that could be accomplished, particularly by inducing people to behave in ways that are very important to the future productivity of this country—investing in child rearing and better enabling middle-class families to invest in their kids, in their education and training. Also, the IRA's would provide an incentive for savings. So we felt we were putting in place incentives for behavior that would be very important to future productivity and, therefore, economic growth in this country.

Senator BREAUX. So a \$704 billion tax cut over 10 years is unreasonable and unacceptable, but \$172.9 billion is something that is reasonable if it is paid for with cuts in other spending programs?

Secretary RUBIN. I think, Senator, that is correct. We feel that a \$173 billion tax cut program is affordable. We put forward the specifics as to how we would do it in the 5-year period. And we think the \$704 billion is not affordable. So far, nobody has shown us how it can be afforded.

Senator BREAUX. Thank you, Mr. Secretary.

The CHAIRMAN. Senator Rockefeller.

Senator ROCKEFELLER. Thank you, Mr. Chairman. Thank you, Mr. Secretary.

Senator CHAFEE WAS TALKING ABOUT HEALTH CARE. And I want to continue that for a moment. Let me just ask you this question flat out. We can cut programs and cut the deficit, not do tax cuts, raise taxes, and we will never get the deficit under control until we get the cost of health care under control. Am I not right?

Secretary RUBIN. Senator, that is absolutely correct. And that is the argument that the President spent a lot of last year trying to make in the public domain. And, as I said, ultimately we were not successful in Congress. But he is fully committed toward the objectives that relate to the comments you just made.

Senator ROCKEFELLER. And did he not, in his presentations during that 2-year saga, have a chart in which he showed the deficit declining until about the year 1998 or 1999, and then it just started going up very sharply?

And the one and only explanation that was always given for that is because that is what will happen if you do not do health care reform. Because the spending in the private sector and the public sector is just going out of sight.

And I want to emphasize that for a moment because I think that one of the decisions that you have made, and the President has made in your budget, is that you have not made cuts in Medicare and Medicaid. And I have to assume that the reason is that, if that is going to be done, you want to see it done within the context of health care reform. At least that would be the implication.



I want to read a couple of statistics here which relate to the Members on this Committee. It is really stunning. In West Virginia, 58 percent of all hospital revenues come from Medicare and Medicaid. In Senator Moynihan's New York, it is 57 percent of all revenues from Medicare and Medicaid. In Senator Packwood's Oregon, it is 43 percent. In Iowa it is 47 percent. In Oklahoma, as of last year, 50 percent. In South Dakota, it is 48 percent, as of last year too.

In other words, there is enormous dependence in hospitals on these programs. Now if, under the Republican contract, Medicare and Medicaid are reduced between \$200 billion and \$600 billion—and the \$600 billion, particularly if they accomplish their tax cuts, it could easily rise to somewhere up in that area over a period of 7 years.

The effect on hospitals would be absolutely devastating. People have to understand that. Hospitals are like universities. They are the employment base of New York City, as well as small rural counties in West Virginia. So I just want to make that point very clearly that what you are doing in not cutting Medicare and Medicaid—although it is probable that they will be cut at some point if the balanced budget does not pass and they are not cut to the \$200 billion or \$600 billion level—is that you are precluding literally scores and scores of rural hospitals being closed down. People in rural areas, seniors and others, would be totally unable to get to health care of any sort, and then simply not try to get to health care of any sort because they do not have the transportation. This would be pretty much a breakdown of the American health care system.

So I think what you have not done is an enormous step in terms of the possibilities for health care.

Secretary RUBIN. Well, Senator, for the reasons you have just given, and many other reasons, cost shifting and things that you know an enormous amount about, having been so involved in health care reform, it is our present judgment—and I think all of our judgments—that while Federal health care expenditures absolutely need to be dealt with if we are going to be effective in dealing with the deficit, it needs to be done in the context of health care reform. And that is precisely what the President wants to accomplish, working with Congress.

Senator ROCKEFELLER. Can I just add that, by the year 2000, at the rate we are now going, if trends do not change at all, 50 percent of Americans who work will not have health insurance—not 50 percent of Americans, but 50 percent of Americans who work will not have it.

I remember last year we were talking about 14 percent of Federal spending comes from health care. And we were all kind of stunned by that. That is so much.

Well, CBO has just come out with new figures that say that, by the year 1998, 3 years from today, that 14 percent is going to be 24 percent; 24 percent of all Federal spending will be health care expenditures.

Now some could turn around and say, well, that is the best reason to eliminate Medicare or Medicaid, or whatever. But, of course, that weaves you into the whole fabric of the American health care

system. So I just posit, as lawyers, which I am not, often do, that you have made a very wise decision. And, secondly, that it may not be the 1,342 pages that people had so much fun with last year, but the need to be serious about health care is as strong this year as it was last year. And the American people know that and place it at the top with crime.

The CHAIRMAN. Senator Graham.

Senator GRAHAM. Thank you, Mr. Chairman. I too wish to commend Secretary Rubin, not only for the outstanding presentation and responses that he has made today, but for the very commendable job that he has done in the few days that he has had this position. I do not know of anyone who has taken on major responsibilities in the Federal Government in recent years who has been faced with a crisis of such potential significance, and handled it with such grace as the Secretary has done.

And, for that, I think all Americans owe him a debt of gratitude, whether they recognize it today or not.

Mr. Secretary, I would like to ask some questions about an issue that I think is extremely important. And that is to continue monetary and fiscal policies that will have as their result as stabilization and lowering of long-term interest rates.

I believe that one of the most significant things that this administration has done for the average American family was that period immediately after the adoption of the economic plan in August of 1993, when there was such a sharp decline in long-term interest rates. Many families refinanced their homes and other items, and have saved an estimated \$100 billion plus as a result of those refinancings. At least that was the number given to us by your predecessor, Secretary Bentsen.

The Federal Reserve Board began a series of short-term interest rate increases approximately a year ago, which had as one of their objectives to maintain the lower long-term interest rates. Long-term interest rates have increased in spite of now seven Federal Reserve actions to attempt to dampen them. Why do you think that has occurred? Why has the result, in so far as long-term interest rate reduction that were intended by the Fed action, not been realized?

Secretary RUBIN. Well, I think that there was a universal expectation that when growth started again, long-term rates would go up to reflect that growth. Because when you have growth, you have more demand for capital. And, almost inevitably, with growth, you have some increase in inflation expectations. Of course that required that growth be sustained, and I think the fact that it was sustained in large measure was a function of the confidence that the financial markets had that we did now have fiscal order. Otherwise, I think we would have gone back into the mode we were in before.

The question always was how much would rates go back up? I think that the levels that they have gone to are consistent with the kinds of growth estimates that we now have in our budget, and will come out in the Economic Report of the President, which I think comes out Monday. The key is that in the period prior to the beginning of this administration, the financial markets—and I can remember this well from when I was there—always put a very large

deficit premium in interest rates because they had enormous skepticism about the ability of this system to deal with the deficit. They saw the deficit going up and up, and up and up as a percentage of GDP. I think that deficit premium is very largely, not totally but very largely, out of long-term rates.

I think an enormous amount has been accomplished. And my judgment is that long-term rates will tend to fluctuate with growth.

Now, just one more comment, if I may. I know this is a long answer to a short question, but it is a complicated issue.

I do think that interest rates relative to inflation—that is, real long-term interest rates—are certainly higher than they have been historically. You can have interesting debates about why.

But my own judgment, and I think it is the judgment shared by a lot of people who have studied these matters, is that there is a strong worldwide demand for capital in the 1990's. It is considerably greater than the demand we have had in prior times. As a consequence, real interest rates are likely to stay higher through the 1990's than they have been.

That is not necessarily all bad, because the worldwide demand for capital means demand for goods and services and for our exports. That is an economic opportunity for us.

Senator GRAHAM. So is it a corollary to your statement that the United States' ability to exercise economic sovereignty on issues like interest rates has been diluted?

Secretary RUBIN. I guess I reach two conclusions from that. One, that fiscal order is absolutely imperative in order to keep that deficit premium out of interest rates and dampen inflation expectations.

And my second conclusion would be that economic sovereignty with respect to interest rates in this country has diminished very substantially over the last some years, especially the last 5 years, as we have come into an era of global financial markets.

The CHAIRMAN. Senator Murkowski.

Senator MURKOWSKI. Thank you, Mr. Chairman. Good morning, Mr. Secretary.

I think it is fair to say that you have the obligation to make the best case of the circumstances as they exist. And I certainly commend you for that.

However, as we look at the chart that has been called to the attention of the Committee, I think one has to recognize that there is a certain reality there associated with the potential that the GDP may indeed decline. The economy could slow down.

And, as a consequence, that chart would look entirely different. And that possibility is always out there relative to the issue of debt.

And it strikes me that one could make a case that we are selling a little snake oil in a best-case basis, vis a vis a worst-case basis, which is always a possibility. I would note that the President submitted a budget last year which projected that the Federal budget deficit over 5 years would add \$918 billion to our National debt. Yet, 12 months later, the President calls for a budget that adds \$996 billion to our National debt. That is \$78 billion more than he projected a year ago.

So one could conclude that perhaps the administration is abandoning the goal of reducing the deficit. The Federal Government's record of spiraling deficit upon deficit, debt upon debt, so we are reaching the point where all the Federal Government's borrowing is really simply to pay interest on the accumulated debt. I wish, Mr. Secretary, that you had brought that chart.

Because, if you look at the deficit for fiscal year 1996 at \$196 billion, you go up to \$213 billion in 1997, \$197 billion, \$194 billion. But we do not say anything about the interest.

Now the interest during those years goes from \$257 billion in 1996 to \$309 billion in the year 2000. By the time we are through with this projection, we have added, over the 5-year period, as a consequence of each year operating at a deficit, a total of \$998 billion more to our accumulated debt, which is now \$4.8 trillion. We have moved it up to \$6.6 trillion.

Now that is a reality. And, to suggest that somehow that we have got the self-discipline to address that, we really do not have a track record of doing it. I am not suggesting that the balanced budget amendment is the way to do it, but it is an alternative to bring about discipline. How do we pay down that accumulated debt when we are borrowing more each year, more each year in interest than the deficit that we are accumulating?

And, Mr. Secretary, you remember what the prime rate was in this country in December of 1980. It was 20½ percent. We are doing projections here based on the best forecast. But there is always that concern out there.

And, if you look at what is going on around us, the problem is too much debt. What happened to Mexico? You were very much involved in that. Too much debt. What is happening in Canada today? Too much debt. Twenty percent of the Canadian budget is interest on the debt. The health care system in Canada, a government-run health system, is eating the country alive. They cannot meet the costs associated with that because there is no incentive to save.

Now I do not accept all the good news associated with this because it is not all the news. And I just cannot see the silver lining associated with the increase in the GDP as being the answer to a reality that we do not have the self-discipline to cut in any other area than the military. That is where the cuts are occurring.

I would ask for your brief comments on whether or not you are going to provide this Committee with a copy of the Mexican loan framework agreement, which I understand you indicated in a letter to Senator Dole that you would be negotiating, and have completed.

And my last portion of the question is with regard to the Tesobonos, and the depth that is out there in the bare instruments. What has happened down there? Are they paying? Are they coming in and calling them, or rewriting them at 20 percent interest as a consequence of the \$70 billion of current debt that is out there?

Secretary RUBIN. I think we agree with you that we have got to maintain fiscal order. I think we are so perceived in both the financial markets and the international financial community.

I think the key is to continue on the kind of track we are on and try to continue to bring down the debt as a percentage of our gross

domestic product and the deficit as a percentage of gross domestic product.

Anyway, that is a one-sentence answer to your comments. But we certainly share your objectives.

On the question of Mexico, the framework agreement is something we would be delighted to share with this Committee. In fact, we have not figured out quite how to do this yet, but we clearly want to remain very closely involved with Congress as we go through this whole Mexican situation. We have got to develop some structure for doing that.

On the question of the Tesabonos, as you correctly say, they had an auction Tuesday. And, on the very short maturities, the interest rates came way down.

Senator MURKOWSKI. What is way down?

Secretary RUBIN. Do not hold me to the numbers, because I do not actually remember exactly.

Senator MURKOWSKI. From what to what?

Secretary RUBIN. I could do the arithmetic if I could remember the numbers. I think the rate on shorter maturities came down from roughly the mid-twenties to the mid-teens, in that area.

On the long end, which is to say the 1-year maturity, they stayed about the same. I do not think that is surprising. We have not worked out final agreements yet with Mexico.

If I were in the financial markets, I would want to see the same thing you want to see, and which you will see. That is a master agreement, the conditions, and all the rest.

Senator MURKOWSKI. But you did not answer my question. Are they cashing them in?

Secretary RUBIN. Oh, I am sorry. They are rolling over some and cashing in others. On the auction yesterday, if I remember correctly, they rolled over about a third, and cashed in about two-thirds.

Senator MURKOWSKI. That is a pretty good investment with a guarantee behind it now for rolling it over at these rates.

Secretary RUBIN. Well, that is what the market in its wisdom has determined.

Senator MURKOWSKI. With the guarantee, of course it helps.

Secretary RUBIN. Well, these Tesobonos are not guaranteed, as you know.

Senator MURKOWSKI. The old ones are?

Secretary RUBIN. No. There are no guaranteed Tesobonos right now.

Senator MURKOWSKI. But there is that guarantee out there.

Secretary RUBIN. No, there is not. We have not reached our definitive agreement with the Mexicans yet, and we are not going to have one unless our conditions are satisfied, and this oil facility is to our satisfaction.

But we fully expect to reach such an agreement. And I believe the markets will react very well to our program.

Senator MURKOWSKI. Well, I am from Missouri. So I will wait for your information.

The CHAIRMAN. Senator Simpson.

Senator SIMPSON. Thank you, Mr. Chairman. Good morning.

Secretary RUBIN. Good morning.

Senator SIMPSON. I am not a banker. I do not know what you are talking about. No, I do.

These are serious issues that you present to us. And these issues are some of the reasons why I decided to come on this Committee because I had served on the Bipartisan Commission on Entitlement and Tax Reform.

And last year in the President's budget, there was a chapter which was most fascinating to me. And it was called, "Generational Accounting". And it explained the horrid tax burden awaiting future generations of Americans as a result of today's spending and debt.

Forget whether it was Ronald Reagan or Jimmy Carter or Bill Clinton or George Bush, and just know what Frank Murkowski has just said. We will vote in April on a debt limit of \$5 trillion bucks. And this budget shows it is going to be \$6.2 trillion down the road. If they are correct when they come, we will accept them.

And so you explained here, in I thought a very excellent way, what is going to happen to young people? There is a question that surely anyone with half a brain can understand. Young persons are paying more in Social Security than they are paying in income tax today. They are not ignorant. They know that. You do not need to go into wizard land to know that that is what young people are doing today.

They know it. In testimony before our Committee, they literally, by a poll, stated that 24 percent of them believe there will be something in the Social Security and 46 percent of them believe in UFO's.

And I believe that. It is probably the same with adults. Anyway, it seems to me that you have left out one of the most important provisions. And my hunch is that you did it simply because the numbers today are more horrifying than they were last year, and that the future looks much worse for young people as to what they are going to be paying in and what they are going to be taking out. And I ask you, why was this left out?

Secretary RUBIN. Actually, Senator, the numbers were more favorable this year than they were last year. It was left out, but it is something we would be happy to discuss it with you. I must admit I am not an expert in this area. It is called "generational accounting", I think. It was left out because it is a very complicated issue. The Kerrey Commission, I think, did a very good job, an important job, in the way they highlighted demographic impacts as we go forward.

Generational accounting is one of a lot of ways of looking at a very complicated problem. It was our view that it was misleading to show only one way of analyzing the problem, as opposed to including material analyzing it in a lot of different ways. But the numbers actually were much more favorable this year than last year for all sorts of reasons.

Senator SIMPSON. Well, Bob, if the Kerrey-Danforth Commission material was so good, how come there is none of it in here?

Because last year this Commission was convened. I sat there. Senator Carol Moseley-Braun was on it. There were many members who have been on this Committee, Pat Moynihan for one. It was a political suicide mission. We all knew that. But we believed

it was necessary for somebody to step up and give cover to politicians and the administration as to what is going to happen to the future citizens of this country.

So we made some tough calls. A lot of us presented some options. Senators Kerrey and Danforth presented an option, which was repudiated by you, and the members could not agree. But nothing we proposed would have affected anyone over 50. And the senior groups have gone bananas in this country, and they will continue to do so.

We had a good Commission. I commend Senators Kerrey and Danforth. They were superb. There were members like Bob Greenstein, who since was a candidate to join OMB, who was on the Commission. He even contributed a proposal to shore up the Social Security system.

And if you say that you liked what we did, I would like to ask you why there was nothing in here that related to the year's work of that Commission?

Secretary RUBIN. Well, as I said, Senator, it was our view that the Commission did a good job in highlighting the impacts of the demographics. They presented a very good chart which showed the impact of demographics and deficits in years as you start to move through the decades ahead.

It seemed to us that it framed an issue, and hopefully increased public awareness of the problems the country faces in decades ahead.

Our response to that actually began 2 years ago, when the President talked about very much the same issue in some respects. He said that, in order to deal with the deficit in a long-run sense, we needed to do health care reform.

So I think it really drives you back to the same issue that we have tried to discuss—I should say he has tried to discuss, particularly last year—and that is health care reform.

Senator SIMPSON. Well, it is absolutely appalling to me that you could skip things like doing something with the CPI. That is an easy one. That is a given. You could go play with that one. The Part B premiums on Medicare, you could do something with that where 25 percent is being paid by the beneficiary and 75 percent by the taxpayer, regardless of your net worth, or your income. Or COLA caps. And you ducked it all.

Secretary RUBIN. Well, our view on Medicare Part B, Senator, is that it and all health care should be dealt with in the context of comprehensive reform. And I think that is a correct judgment. But that is obviously a debate one could have.

Senator SIMPSON. Well, it is appalling to me that you can come through a year's work by a Commission where 30 of the 32 of us gave the exact scenario for America as to what is going to happen to young people, and you ignored every shred of it.

Secretary RUBIN. I really do not think, Senator, that I agree with that characterization. We are very much focused on the same problem. And I think that the work the Kerry Commission did, as I said, is very helpful in terms of creating public awareness of the problem.

I think it leads us to the same place we have been at all along. It may lead you to a different place, but it leads us to the same

place, which is to continue with the discipline that our budget contains and to return to the issue of health care reform. And maybe it will provide additional impetus for health care reform.

The CHAIRMAN. Senator Pryor.

Senator PRYOR. Mr. Chairman, thank you.

Mr. Chairman, I had a hard time believing what I was hearing a moment ago when my good friend from Alaska, Senator Murkowski, started talking about 1980 and the interest rates of 20 percent. And the implication at least was that this President is responsible for a \$4.7 trillion national debt. That is not the case.

I did not want the record to go forward with any implication whatsoever hanging out there to that effect. In fact, in 1981, when President Reagan took the oath of office, there was a \$1 trillion national debt. When President Clinton took the oath of office, there was over a \$4 trillion national debt.

It was during the period of the 1980's, the excesses of the 1980's, that we let the horse out of the barn. And we now are faced with a vote in a few minutes on the first of a series of amendments on a proposed Constitutional amendment to balance the budget, which is supposed to cure everything and bring us back into balance.

But I did not, Mr. Chairman, want that to go unnoticed. I wanted not only to defend this President, but this Secretary and his budget for what we have attempted to do in the last 2 years in bringing the deficit under control, and finding a glide path to a zero deficit budget.

Senator MURKOWSKI. I wonder if my friend from Arkansas would yield.

Senator PRYOR. I will be glad to yield.

Senator MURKOWSKI. I would just, in deference, point out that it is the Congress, of course, that goes through the appropriation process, not the President.

Senator PRYOR. Well, the implication I am afraid my good friend from Alaska was leaving was that this President is responsible for a \$4.6 or \$4.7 trillion debt. And that is not the case.

In 1993 we actually went \$600 billion along the glide path to reducing that deficit. I must say that we have gotten no support from the other side of the aisle in that proposal. I hope that we will all be very realistic as we vote this afternoon, and during the course of the next several days, on the balanced budget amendment.

Yes, all of us want a balanced budget, but we have now got to find the way to bring this thing under control. And we have got to work not as Democrats and Republicans on it, but together to find a satisfactory solution to it, as perhaps Senator Conrad has just proposed.

But my question, if I have any time left, Mr. Secretary, is that let us say hypothetically, if we come to the year 2004, or let us say we have the final State that has ratified the proposed amendment we are now debating on the floor, and then 2 years after ratification, as the amendment calls for, we have to have a balanced budget. And we in Congress have done nothing in the ensuing time.

Where do we find that amount of money? What happens to the markets? We worry about the Mexican currency now. Will we be worried about our own currency at that time, if we have that short of a window to balance the Federal budget?



Secretary RUBIN. Senator, I think that would put the country in an untenable position. It is hard for me to imagine what would happen if we did not work our way to budget balance over a rather substantial period of time. Because what you would have to do is make enormous budget cuts in a very compressed period. The macroeconomic impact, I suspect, would be horrendous. Then Congress would have to figure out some way to get out of the mess.

I think you would be in a position, with the macroeconomic impacts, of so compressing the budget cutting that it would simply be unacceptable to the country. I suspect that you would be in a severe recession if you had to go through with that program.

Senator PRYOR. And what would this do to the markets?

Secretary RUBIN. Well, when you have severe recessions, the interest rates come down. But that is not a very healthy way to get interest rates down.

Senator PRYOR. Would we be printing more money to comply with the mandates of the balanced budget amendment?

Secretary RUBIN. Would we be printing more money? I had not thought about it from that point of view, but I think the real problem would be that you would have to reduce the deficit so rapidly, to accomplish the task in such a compressed period, that it would have enormous negative effects, macroeconomic impacts. I have not done the analysis, but I would guess that it would put the country into a recession, a severe recession.

Senator PRYOR. Mr. Secretary, thank you very much.

The Chairman, I yield back my amount of time, two or three seconds.

The CHAIRMAN. Senator Grassley.

Senator GRASSLEY. Mr. Secretary, the administration's budget supports a permanent extension of the 25 percent tax deductibility of health insurance premiums. That is for the self-employed, you know.

Secretary RUBIN. Right.

Senator GRASSLEY. The House is going to bring up H.R. 831 today that does the same thing. Is the White House backing that proposal?

Secretary RUBIN. Senator, we support the proposal. The question is, how do we pay for it? And Assistant Secretary Samuels is going to be meeting with the relevant people over on the House side early this afternoon on that subject.

Senator GRASSLEY. So there is no doubt about it. You support at least their enactment of it now. It is just a question of the offset.

Secretary RUBIN. We absolutely support enactment of the provision. I think the question is how we pay for it.

Senator GRASSLEY. Yes. Then, if I could ask you, as an extension of that very same point, if you could give me an administrative position, if they have one, on increasing the deduction to 100 percent, if it is paid for. And, as you may know, Senator Pryor, Senator Roth, and I on this Committee have introduced such a bill to make it 100 percent by 1997.

Secretary RUBIN. Senator, I believe that the increase to 100 percent was in the HSA, the Health Security Act, last year. So we would still favor that. But it does raise the very big question which you have raised, which is how do you pay for it?

Senator GRASSLEY. Well, we all know that it has to be paid for. In regard to the targeted jobs tax credit—

Secretary RUBIN. Senator, I know I am repeating myself, but we would only favor it if fully paid for.

Senator GRASSLEY. Yes. All right.

In regard to the targeted jobs tax credit, does the administration have a proposal to deal with any underlying problems that are alluded to in your budget?

Secretary RUBIN. That is an issue, Senator, for which at the moment we do not have a proposal. I think it is discussed in the budget. That is a subject we are focusing on. And we will get back at an appropriate time.

Senator GRASSLEY. Your budget does bring up the problems, and I assume that, with it being in the budget, you support it. But you want those problems taken care of. Is that right?

Secretary RUBIN. I think it is fair to say that, conceptually, it is a provision that we have been in favor of. But we are troubled. We are concerned about the problems. I am not an expert in it, but I do know there is a process going on with respect to looking at those problems and seeing if this is the best way to proceed, or if there is a better way to proceed.

Senator GRASSLEY. My next question deals with your proposal for middle-income tax cuts and the dependency allowance. That is going to be \$300 for fiscal years 1996 through 1998, and then it goes up to \$500 in fiscal year 1999. In addition, that tax credit is limited to families with children under thirteen years of age. I assume that the administration does not have any studies showing that it is cheaper for kids under 13 than for kids over 13.

Secretary RUBIN. No. But I think there would be—

Senator GRASSLEY. What is magic about the 13?

Secretary RUBIN [continuing]. I think there was a view, and this is a subject we actually discussed at some length, that when you deal with younger children, you are dealing with younger families. And younger families, particularly middle-income families, tend to be more financially strapped. And younger children involve certain problems like child care and after school activities. So you are both getting at the families that have the most difficult time financially, and also getting at children at an age where there are certain special expenses.

So, with limited resources, it seemed that this was the best possible targeting for the amount of money available.

Senator GRASSLEY. Well, it reflects your priority, I suppose, for emphasizing younger kids. But when it comes to that priority, how do you compare that, or justify that compared to a 9.8 percent increase in the IRS, or giving families a bigger tax cut, or even using the money to hack away at the budget? It would seem to me that is not a proper priority compared to where you put these other priorities.

In other words, if you were not doing these other things, it would seem to me you would be able to have it for teenagers, as well as people under 13.

Secretary RUBIN. Well, I think this is exactly the kind of debate that one needs to have. And we obviously did have this internally. That is exactly the right framework, I think. You have a limited

amount of money, how do you best use it? It was our judgment that this child tax credit, as we designed it, was a better use of the money than the alternatives. Beyond that, there were other uses that were better than extending it to children between 13 and 19.

Senator GRASSLEY. One last—

Secretary RUBIN. Every budget decision, as you correctly say, is a choice between the possibilities.

Senator GRASSLEY [continuing]. One last point, and it is not a question, because I am working very closely with your staff, as Senator Pryor is, on the Taxpayer's Bill of Rights.

The President volunteered to me, when we were down at the White House on welfare reform a week ago Saturday, that he liked what Senator Pryor and I were doing. He spoke very generally about it. He offered it, I did not ask him. But I hope that means that we will be able to work out our differences very pleasantly.

Secretary RUBIN. Senator, as you know, we are very much in sympathy with the objectives you have, and look forward to working with you successfully toward a Taxpayer Bill of Rights.

Senator GRASSLEY. Thank you, Mr. Secretary.

The CHAIRMAN. Senator Moseley-Braun.

Senator MOSELEY-BRAUN. Thank you, Mr. Chairman.

Mr. RUBIN, WELCOME. I was on the floor debating the right-to-know amendment for the balanced budget amendment. I support both the balanced budget amendment and the right-to-know provision because I think it is so important that we share as much information with the American people beforehand, before the hard decisions have to be made, as we approach and debate this issue of deficit reduction and trying to achieve some balance in the budget.

In that vein, I would like to pick up where Senator Simpson left off, and ask the question with regard to the intergenerational analysis of the budget. With regard to the information that was compiled with the Kerry Commission, in light of the fact that it was in the last budget submitted by this administration, why this time did you opt for less information, instead of more?

Secretary RUBIN. On intergenerational accounting?

Senator MOSELEY-BRAUN. Yes.

Secretary RUBIN. Because the numbers are actually more favorable this time so, in a sense, you could say we should have put it in there. But we met and talked about it, and it was our view that it was only one way of many ways of looking at the question of what kinds of effects budgets today are going to have 30 and 40 years down the road.

When you start talking about 30 and 40 years down the road, you obviously are getting into extraordinarily speculative issues. So it seemed to us misleading to present only one set of perspectives, as opposed to having many sets of perspectives. That was the reason we deleted it this year.

Senator MOSELEY-BRAUN. One of the major, the underlying themes, in the issues we are dealing with, and the whole discussion about balanced budget, has to do with our capacity and our ability to deal with long-term trends and the kind of fiscal order we leave our house in, if you will, for the next generation, what we do to the future Americans who hopefully will have some Social Security,

some health security. I mean those are the issues that we are debating.

And I come back again to the fact that it is not like the data would have hurt anybody. If anything, because of the capacity of the administration to get information around, that would have provided an opportunity for the administration to present the information and data that we on the Entitlement Commission had, in order to address some of the long-term trends.

We should not be focusing as narrow a lens on this issue when we have the opportunity and the capacity to focus on a broader one.

Secretary RUBIN. Well, Senator, it was our view, and maybe a mistaken one, but it was our view that the Kerry Commission had very usefully highlighted the problems that this country faces 20, 30 or 40 years down the road. And the particular approach that we are now discussing is only one of many approaches to projecting what the outlook will be 30 or 40 years down the road in a situation that is inherently highly speculative. So we decided that having it in the budget was in a sense less useful than not having it in there.

As I said, the numbers were better than they were last year, so it was not a question of trying to take numbers that had gotten worse and not disclose them. Quite the contrary—they were actually better.

Senator MOSELEY-BRAUN. Well, we would have liked to have seen it, I think.

Secretary RUBIN. Well, we can get you the numbers. That is not a problem.

Senator SIMPSON. Well, I am just stunned. If everything in this budget is cotton candy, and better, why did you leave out something that was better?

Secretary RUBIN. Senator, I do not think everything is cotton candy. This budget involves enormously difficult choices. If you do not believe me, you can ask some of the people who are trying to deal with them right now.

You ask Secretary Cisneros or Secretary O'Leary what it is like trying to restructure their agencies to meet the requirements of our budget. I think they will tell you that they are going through a very difficult time. This is not a cotton candy budget. I think it is a very tough-minded budget.

Senator SIMPSON. Well, I apologize to my friend from Illinois, but I am just stunned. I have heard you say three times that the numbers were better, so you left them out. And that is rather appalling. I do not understand it.

I apologize to my colleague. Take the time off from me the next time.

Secretary RUBIN. Senator, I think it is kind of a testament to a certain type of intellectual honesty. It is one perspective on some very difficult issues, so we took it out. But we can get you the numbers and the analysis. That is not a problem.

Senator MOSELEY-BRAUN. Well, let us talk about information and something more concrete.

In 1993, when I first got here, I was really delighted to have a chance to engage in real deficit reduction, the President's budget then.

I do not know if this issue has been explored, but at the time, the President's budget gave us \$500 billion worth of deficit reduction over 5 years.

And this time around, with the deficit still hanging in at about \$193 billion, according to this, at 2.7 percent of GDP, with the deficit still being as persistent as it is, and we all know that it up-ticks again in 5 years. You know, in 5 years, the turn of the millennia sounds like a long way away, but it really is not. It is only 5 years from now. Why then was more not done for deficit reduction with this budget?

Secretary RUBIN. Well, Senator, the judgment that we made was that we wanted to present a budget that had both tax cuts, which we thought served very important purposes, particularly incentives for people to engage in savings, in education and training, and also provided resources for child rearing—things that we thought were very important in terms of future productivity. And we wanted deficit reduction.

So we presented a budget that has in the first 5-year window about \$63 billion on tax cuts and about \$80 billion in deficit reduction.

Then, in the second 5 years, we project substantially more deficit reduction. As we discussed earlier, it does continue the very powerful deficit reduction program that we began in 1993, as you said. We do not show the full 10 year projection in the budget, unfortunately. If we had, the figures would show us on a track towards the deficit being 1.6 percent of GDP in the year 2005.

On top of that, our recommendation—

Senator MOSELEY-BRAUN. Excuse me, Mr. Rubin. The budget here says 2.1 percent.

Secretary RUBIN. Yes. That is in the year 2000.

Senator MOSELEY-BRAUN. Oh, all right. That is 2005. I am sorry.

Secretary RUBIN. I am sorry. In 2005 it is 1.6 percent. That is correct.

Secretary RUBIN [continuing]. And on top of that, our suggestion is that Congress and the Administration engage as quickly as possible on reforming health care.

Senator MOSELEY-BRAUN. Well, just off the top of my head, and I am not the mathematician of this room, but it seems to me you could have gotten it down close to 2.1 percent this time around, had it not been for the \$63 billion devoted to tax cuts.

Secretary RUBIN. You mean this time being this year?

Senator MOSELEY-BRAUN. Well, no. It would have been about 2.5.

Secretary RUBIN. Well, it is 2.7 percent in the current fiscal year.

Senator MOSELEY-BRAUN. Two point seven now?

Secretary RUBIN. Yes. You are about right. Well, that is the debate. Our judgment was that the nation was better off with that \$63 billion being spent on tax cuts rather than an additional deficit reduction. But that is a very good debate to have.

Senator MOSELEY-BRAUN. My time has expired. Thank you very much, Mr. Rubin.

The CHAIRMAN. Senator Chafee.

Senator CHAFEE. Thank you, Mr. Chairman.

Mr. Secretary, Senator Conrad presented what I thought was a very good idea. And you seem to reject it. What Senator Conrad's suggestion was, as I understood it, that the Budget Committee of the House, the Budget Committee of the Senate and the administration each come up with a plan of how each group would reach a balanced budget by the year 2002.

Now, you are not going down that path. You prefer to present it as a percentage of GDP, and all that. And that is nice, although on a percentage of GDP, you could come down with the percentages and go up with the actual dollars of the deficit. And it is the dollars in the deficit that our children are going to have to pay someday. And certainly they are going to have to pay the interest on it.

Why did you reject Senator Conrad's proposal? Could you go into that once again on Senator Conrad's proposal?

Secretary RUBIN. I agree with you that it is the dollars in the deficit that our children will have to pay, but it is out of their income they will have available to pay it.

And the point that I was trying to make, maybe not terribly well, is that the right way to look at it, at least in our judgment, is you have: to pay dollars to service the deficit and the debt, but your ability to pay depends on your total income. That is why the deficit to GDP ratio strikes us as the right way to look at this.

If I understood Senator Conrad correctly, he said that there would be legislation that would mandate a balanced budget by 2002. And then you would have the Republicans, the Democrats and the administration all come forward on exactly the same day with their cuts.

I had two different reactions. I do not think we should arbitrarily set any date for a balanced budget for the reasons that I gave in response to Senator Conrad.

I think that it does not behoove us to create rigidities with respect to macroeconomic policy. I have an instinct as well, having worked our way through this budget, that if you wanted to put the whole deficit reduction process on track toward balance during the period between now and 2002, you are going to have more macroeconomic pressure than you would be comfortable with once you actually lived through the period.

And then I had the automatic stabilizer comment which I made.

The piece that I would react favorably to, that would strike me as very sensible, is that if you are going to have an arbitrary deadline, which I do not think is a good idea, then have each of the three relevant parties—two Congressional parties and then ourselves—come forth with specifics. I think that is a very constructive suggestion. Then people could look and say that, independently of the macroeconomic impact, here are the specifics. Either we are willing to forego all this to get to a balanced budget, or we are not.

Senator CHAFEE. Well, as you know, we have this balanced budget thing. Nobody wants to go first because it might be politically unpopular. And so that, I thought, was the beauty of Senator Conrad's idea.

Do you suggest that this country cannot reach a balanced budget by the year 2002? Are you suggesting that is too rapid a decline from the situation where we are now? That is what, 6 fiscal years

from now? I know you mentioned the vicissitudes of the economy, and so forth, but we have got to assume that Senator Conrad's provision has an escape hatch if X percentage of the Senate so votes, three-fifths or whatever it is.

But my real question is, is it impossible, without disturbing things too dramatically, to reach a balanced budget by 2002?

Secretary RUBIN. Senator, you could reach a balanced budget any time you want, I suppose.

The question is exactly the one you framed, which is how much impact would it have?

If you like, we can try to model that, using existing macroeconomic models, and come back to you with the effects. I think what you will find is that trying to get from here to a balanced budget in the year 2002 has more negative macroeconomic impact, even allowing for the offsetting lower interest rates, which I presume you would have, than you all would choose to have. But we will be happy to get back to you on that.

Senator CHAFEE. Well, I find that suggestion terribly discouraging.

On a more specific thing—

Secretary RUBIN. Senator, can I ask you a question? I am not supposed to ask questions, but why 2002 instead of 2005 or 2001? I guess our answer is that we should move toward a balanced budget, but we should do it each year by making tough decisions that are appropriate in the context of whatever the then economic circumstances are. Then we can make the judgment you just asked every year as we go along.

Senator CHAFEE [continuing]. Well the trouble is, unless you have a specific date, you, we, all of us would find splendid excuses not to do anything.

And there is nothing better than to say that we would like to get there, and we are prepared to make these tough decisions, but that would be so dramatic in affecting the economy—and we would work the word macroeconomics in there somewhere—that we had better not do it.

And I just find that, if this country cannot reach a balanced budget in 7 years—I guess it is 6 fiscal years—then something is dramatically wrong with us.

And could I ask just one quick question here? The special IRA's, which in the past we around here have called backloaded IRA's in that you do not get a deduction when you put money in, but when you get it out. Now that is an idea of Senators Bentsen and Roth of a few years ago. And I led a sterling fight against it on the floor and received 28 votes.

And so it passed. And I think it is a terrible proposal because, under our accounting procedures, its true cost does not show up in the budget estimates. The dramatic cost of it does not show up under the way we do our budget procedures here.

Secretary RUBIN. Well, I think your point is actually an extremely good point. It is our view that you should look at 10-year numbers on these things, as well as 5-year numbers, as you just said. We have 10-year numbers on the IRA, as we proposed it, and we think we should look at 10-year numbers on all of these tax proposals.

Senator CHAFEE. But why do you push this thing when, on your 10-year figures, it will show that it is very very expensive?

Secretary RUBIN. We advocate it because we believe that there is a good chance, although there is no certainty, that this will actually begin to have an impact on savings and that it can be an effective mechanism, not just because it is backloaded. I think if it were only backloaded, we probably would not have proposed it. But it is the combination of the backloading and the greater flexibility with respect to the use of the funds that, in our judgment, gives it the real possibility of increasing savings.

Senator CHAFEE. Thank you, Mr. Chairman.

The CHAIRMAN. Are you familiar with the exchange of correspondence I had with Secretary Bentsen, and then Secretary Newman and Secretary Samuels on capital gains?

Secretary RUBIN. I am familiar with it, though not in any detail.

The CHAIRMAN. I see Secretary Samuels behind you.

Secretary RUBIN. As I said, I am aware of it, but not familiar with it.

The CHAIRMAN. I asked them to estimate the Bush capital gains proposal, first based upon what the facts were in 1990. And they estimated, and they said yes, we stand by the estimate in 1990 of about a \$12 billion gain.

Now we estimate the same capital gains proposal but now, under current economic facts, they reestimated it at about a \$400 million loss over 5 years which, for all practical purposes, is neutrality.

Correct me if I am wrong, but just for the record, I wanted to indicate that the Treasury Department would say currently that, if we were to pass the Bush proposal on capital gains, it would be about a \$400 million loss over 5 years.

Secretary RUBIN. My recollection is that this is correct.

There were a number of Bush proposals. And Assistant Secretary Samuels corrects me by saying that this was a prototype of a number of different proposals that President Bush had put forward.

The CHAIRMAN. When Dr. Reischauer testified on the President's health plan, he said, "It will save us one percent if it works. In full effect, and when it works, it will save us 1 percent, and we will spend 19½ percent of our gross domestic product, rather than 20½ percent." And Senator Durenberger said, "But we are at 14 percent now."

And this presumed that it worked. If all the caps worked, and everything worked perfectly, and none of us had any great faith that it would work perfectly.

But, even if it had been implemented and it had worked, we would have been going in the direction of health eating up more of our gross national product.

There is no question but that retirement is going to eat up more of our gross national product. So, let me ask you philosophically—you know the figures, you know where it was in 1964 and 1974 and 1984—is that the right direction, or philosophically should we be trying to say that we have got to, if not reduce, dramatically change the increase in health and retirement in this country?

Secretary Rubin. Well, if I recollect correctly, what you had is what you just said, an increase not in the budget, but in the national health system—



The CHAIRMAN. What he said was that if we do nothing, the baseline we would have is at 25 percent.

Secretary RUBIN [continuing]. Yes. But I remember that under the Health Security Act the growth in national health expenditures would have been significantly reduced.

This problem has developed over a very long period of time and, as I recollect CBOs scoring of the Health Security Act, what it said basically was that following the year 2000, national health expenditures would fall below the baseline by increasing amounts. CBO projected that, when fully implemented, the Health Security Act would significantly reduce the projected growth of national health expenditures.

So it was a long-run solution to a problem that has developed over a long, long time. My view is—and, more importantly it is the President's view—that we need to put in place some kind of a program that accomplishes that purpose. But the program is not going to reduce the share of GDP overnight.

The CHAIRMAN. If, at the end of it, we were at 19½ percent.

Secretary RUBIN. Well, I guess that was my point. In the long run, CBO said that the Health Security Act would reduce national health expenditures by increasing amounts each year after 2000.

The CHAIRMAN. That was the end point. At the end point of our projections. I do not think we projected at 15, 20, 15 years. It was the end point of our projections.

Secretary RUBIN. Well, it may have been the end point. It was the end point of a set of projections. I think you are right about that.

The CHAIRMAN. Right. Let me try it again then. In 1964, the four big entitlement programs. The Government has got 410 entitlement programs. The bottom 400 cost plus or minus about \$50 billion. Some of them cost less than \$5 million. And maybe, on merit, they ought to be gotten rid of or not gotten rid of. But it is 400 of them. The big four—Medicare, Medicaid, Social Security, and other Government retirement—plus interest, cost \$900 billion.

Those four, plus interest, go up more than all the 400 put together. And the 400 are the paper clips and pencils. We can nibble around the edges if we want, but we are not going to make any great difference in the deficit. And we are all afraid to talk about or look at the top four.

Social Security off the table. Medicare is off the table. Medicaid may be on the table, but the only kind of cuts we could make, if we make them, the States will scream bloody murder because it will be money that we are giving to the States. Interest has to be off the table. And you cannot get it out of the poor veterans and the retired Federal employees. There just is not enough there.

And yet, I do not see anything in your budget, Mr. Secretary, or in our efforts—I mean the Republican efforts—that point us in the direction of starting to have those percentages reverse themselves.

Secretary RUBIN. Senator, I think that we would have a view very much like yours.

The President spent 2 years trying his best to get health care reform. And he was unsuccessful. So, as I said, I think the decision we made was not to put this back in the budget and once again

put forth a proposal, but rather to suggest that we ought to work together.

So I think we agree with you in your objectives. The question is how we actually get something done. You would have far greater wisdom on that than I would.

Senator MOSELEY-BRAUN. Will the Senator yield for a second?

Mr. Rubin, did you just say that you agree with that? Senator Packwood's point is very well taken. It seems to me that this budget and the pronouncements have been that Social Security is going to be off the table for purposes of the discussion about deficit reduction and balancing the budget.

And you just contradicted that, or did I mishear?

Secretary RUBIN. No. I think you misheard. I said that I absolutely agree with the Senator, as does the President, that Federal health care expenditures and the rate of growth of Federal health care expenditures have to be slowed down.

Then what I said, I think, was that it needs to be done in the context of health care reform. The President did his utmost last year to attempt to accomplish that, but we were unsuccessful.

And the judgment was not to try to get ahead of the process again through the budget, but rather to try to work with Congress to accomplish that.

Senator MOSELEY-BRAUN. But health care reform is only one part of it. Health care reform is one of the big four that he is talking about.

Secretary RUBIN. I understand that, Senator. You are correct about that.

Senator MOSELEY-BRAUN. Well, we need to just be honest and candid about this instead of trying to slip around and say, well, we will talk about this part, and not talk about the other.

Secretary RUBIN. Senator, I think from the beginning of this process, back through the transition, and then in the 1993 budget, and right through the present moment, we have been extraordinarily candid about budgetary matters. And we have had numbers that have been reliable.

Senator MOSELEY-BRAUN. I am not arguing with your numbers. Please, I do not mean to be—

Secretary RUBIN. Now let me get right to the very point you raised, if I may.

On health care reform, we did our darndest. We were unsuccessful. Now we want to move forward. Those are the entitlements that are growing most rapidly. That is the problem in the deficit over, say, the next 10 or 15 years.

Clearly, as you look farther out, as the Chairman said, there are Social Security issues.

I will be presumptuous for the moment, and make a suggestion that you would be aware of far better than me, and that is the politics of dealing with it.

Fortunately, those issues are out a bit in time. What is facing us much sooner are all these questions of the health care entitlements.

To just go back to what I said once before, health care reform is the way to deal with it. And we are fully prepared to engage in that process any time people are willing to begin working with us.

Mr. Chairman. You know, it may take a bipartisan approach. But, at some stage, some of us have got to be the first ones out of the trench. We do not all come out holding hands together somehow.

I have come to support term limits for a reason almost totally different from other people. The argument is that, if you have term limits, it takes a long time to understand the problems around here. And, as soon as you understand them, you are gone.

The dimmest wit in the freshman class in the Congress can understand these problems. It is not incapability of understanding; it is unwillingness to do it.

So I am going to talk about this. And maybe, sooner or later two or three others will stand up. Senator Simpson is ready to stand up. Senator Chafee is ready to stand up. I sense Senator Moseley-Braun is ready to stand up. Maybe we will get there if a few of us will talk about it. But no one in this budget year is talking about it now—not you and not us.

Senator MOYNIHAN?

Senator CHAFEE. Well, could I just say one other thing. We are going backwards. Because, under the proposal in the Contract with America, the inclusion of Social Security in taxable income is cut back from what, 85 to 50?

Secretary RUBIN. To 50.

Senator CHAFEE. So it is not going in the direction you want to go. That proposal is making the fiscal situation for the Social Security Trust Fund worse.

The CHAIRMAN. Senator Moynihan.

Senator MOYNIHAN. Yes. The Secretary was speaking of the proximity of the health care issue. But may I say, a much more important issue is that in about 20 minutes time we will have our first vote in the Senate on a Constitutional amendment to write into our basic law of the land the political arguments of the last 15 years.

Senator Moseley-Braun was speaking on that subject this morning. We will all be voting.

And you, sir, very self-effacingly said that you are not a Constitutional expert. But you will not mind my saying that you are not allowed not to be a Constitutional expert.

On your wall at the Treasury Department is a not very good portrait of Alexander Hamilton, the first Secretary of the Treasury, who was a considerable Constitutional expert. He helped write it in Philadelphia. And he was a considerable Secretary of the Treasury. At a luncheon with Thomas Jefferson on Maiden Lane, he reached agreement that if the Federal Government would assume the debt of the States during the Revolutionary War, he agreed to move the capital from its natural site in Manhattan to a swamp on the banks of the Potomac. [Laughter.]

We have been in trouble ever since.

But, if I could ask your associate to put up that other bar chart once again, if you look over there for the years 1962 to 1968, you see the Federal Government budget in surplus. And that is what the fiscal planners thought was their most important problem, that the Federal Government revenue system was taking money out of the economy, not returning it. And that is why from Walter Heller

to George Schultz, they produced a full employment budget which had a deficit built into it in order to compensate for this.

These are temporary events. These are one-time events. They go 4 years, 8 years, 12 years, and then they reverse themselves. They are not events to which you respond by desecrating the Constitution. History will curse us if we do this.

Now, sir, the administration has been strangely passive on this issue. Yesterday, the Chairman of the Council of Economic Advisers wrote a very fine piece in the Washington Post. But may I ask you, sir, does the President oppose the balanced budget amendment?

Secretary RUBIN. Yes. Absolutely and unequivocally.

Senator MOYNIHAN. There you are. Good for him. [Laughter.]

Secretary RUBIN. And, to express it in non-constitutional terms, I think one of the reasons is that you put arbitrary constraints on economic policy by putting it in the Constitution. And, in our judgment, that can have all kinds of very serious adverse effects.

Senator MOYNIHAN. In your term, rigidity in macroeconomics.

Secretary RUBIN. I think what you do is create an economic straight jacket.

Senator MOYNIHAN. May I say that this is one of the arguments against term limits. In the 1970's, there was a movement to call a Constitutional convention under Article V by the petitions from the States. Thirty States did so petition.

I asked Charles Schultz, a very eminent economist, then in the White House, would he run the 1975 recession with a balanced budget amendment? He agreed to do that. Then he wrote me back to say that the computer blew up. GDP revenues went down \$100 billion which, at that time, was a considerable number. And gross domestic product went down 12½ percent.

Secretary RUBIN. That, Senator, is precisely the kind of problem that a balanced budget amendment can get you into. It is exactly why—

Senator MOYNIHAN. Well, fight man! [Laughter.]

Secretary RUBIN. We have been fighting with all of the energy that we can muster. And we continue to fight.

Senator MOYNIHAN. We have an upper- and lower-class bill of rights that is going to give us a little tax cut of some kind. But there is a much more important bill of rights in the Constitution. We do not fool around with the Constitution.

Secretary RUBIN. We absolutely agree. We certainly do not want to fool around with it for this purpose. We absolutely agree with that. You may be right more generally, but I am restricting myself.

Senator MOYNIHAN. Sure. The President is against this amendment. And he should be telling the Senate not to adopt it. We are starting the voting at noon today.

I am very pleased with what you say. The President is against this. And I hope he would help in a matter that is profoundly important to the Nation.

Secretary RUBIN. He is opposed to it, Senator. And he has been opposed to it consistently. And he sent a quite powerful letter outlining the reasons why he is opposed to it. That was some months ago.

Senator MOYNIHAN. We have been bringing the deficit down the last 2 years.

Secretary RUBIN. And he has, I think been extraordinarily courageous in dealing with the deficit. He has inherited a truly terrible mess.

Senator MOYNIHAN. I was Chairman of the Committee, and I went through that. If you will recall, we had 50 votes plus the Vice President. But we did it.

Secretary RUBIN. But the Vice President voted with us.

Senator MOYNIHAN. And the Vice President voted with us. And we can do it again.

Secretary RUBIN. I was very much in favor of our program, I might add.

Senator MOYNIHAN. And we can do it again.

Secretary RUBIN. And I think that that fiscal courage has continued through this budget. And I think the next place it should manifest itself, as it did during the last 2 years, albeit unsuccessfully, is in dealing with health care reform.

Senator MOYNIHAN. First, leave the Constitution out of this.

Secretary RUBIN. We agree.

Senator MOYNIHAN. Thank you, sir.

The CHAIRMAN. Senator Graham.

Senator GRAHAM. Thank you, Mr. Chairman.

I would like to continue that discussion. Bob, you said that there had been a deficit premium built into long-term interest rates, and that that premium was largely a psychological product of people's lack of confidence that the Federal Government would in fact deal with the deficit.

We have had some political statements to the same effect recently, if you could interpret November 8 as being a statement that the American people wanted a different approach vis a vis our long-term fiscal house being placed in order.

What would you give to the American people, and to the financial markets today as the best evidence that there is a sustained, irrevocable commitment by the Federal Government, over a reasonable period of time, to deal with, ameliorate, and eventually eliminate the additions to the national debt?

Secretary RUBIN. I guess there are two things that you could show to the financial markets and to the American people. I believe that our budget is another step forward, in terms of fiscal discipline to get the deficit down. We have had that discussion here at length. So I would advance our budget and the President's determination to reduce the deficit that he has manifested since he has been in office.

The other side of the coin, and the thing that has troubled me somewhat, is that the Contract with America, it seems to me, creates insuperable obstacles to fiscal balance because you need \$725 billion over 10 years just to pay for the tax cuts, before you even begin to deal with the question of balancing the deficit.

And the concern that I have had is that the financial markets would think that, if in fact those tax cuts become law, how are we ever going to get fiscal discipline in this country?

So on the one hand, you have our budget which, although we could debate whether we should have tax cuts or not have tax cuts,

nevertheless continues the considerable movement forward in getting the deficit down, particularly as a percentage of GDP, which is the way we look at it. The Contract with America, I think, very much moves in the opposite direction.

Senator GRAHAM. Well, since the American people elected a majority of the Congress which, at least in one House, was committed to the Contract with America, what does that say about long-term confidence that there is the political will to deal with the deficit?

Secretary RUBIN. Well, I guess my view of this—and it must be the financial market's view as well since you really have not had the kind of adverse reaction to the Contract with America that you might—is that you have to see this process work itself out.

But if there really is the kind of commitment to fiscal discipline which I have found during my testimony before both Houses, that would seem to be inconsistent with the Contract with America. And it must be the view of the markets that ultimately the Contract with America is not going to be American fiscal policy.

Senator GRAHAM. I think the most compelling argument for the Constitutional amendment is the absence of the persuasive argument that there is the political will over a sustained period of time to do those things that will be necessary in order to overcome this decade of binge of deficits.

Secretary RUBIN. Well, I would argue that if we could actually stay on that track, the track of getting the deficit down to 1.6 percent of GDP, then that is an enormous accomplishment in terms of the fiscal health of this country.

And if you can add to it health care reform, you obviously could go further.

I think the problem with the balanced budget amendment is that, while it does do what you have just said, it also has, in my view at least, very substantial negatives that go with it, or problems that go with it, that I think greatly outweigh the benefits.

I actually think it is quite dangerous economic policy.

Senator GRAHAM. I would like to ask a somewhat technical question within the Constitutional amendment. And I would like to ask if Senator Moynihan might listen to this. I know this is an issue in which he has had a long-time interest.

As I read the balanced budget amendment, it Constitutionally mandates a consolidated Federal budget. That is, all elements of revenue, with the exception of principal repayments. All elements of expenditure must be looked at together. That means that Social Security is Constitutionally required to be mingled with the rest of Federal expenditures.

In 1983, in large part through the leadership of people such as Senator Moynihan, we moved to a Social Security system that was intended to be a surplus-generating system, raising up to a trillion dollars of surplus, and then a rapid draw-down of that surplus as the demographics required.

My question is, in that context of a mandated consolidation of the Federal Budget and the implications of this surplus, can we sustain those? Can we have a balanced Federal budget, particularly during that period when Social Security is being rapidly drawn down? Or, if not, should we be moving now back to a pay

as you go Social Security system so that we do not have that roller coaster that is currently built in?

Secretary RUBIN. That is a question, Senator, which I think I would like to think about before responding.

But I will say this. Your point is well taken. In order to get to the balanced budget by the year 2002, from where we are today, I think that you are either going to have to make enormous cuts on the discretionary side, or you are going to have to do something very substantial on the Medicare, Social Security side.

In fact, I do not think you can get there on the discretionary side. But, if you include defense and all the rest, I suppose with cuts that are beyond anything that you all could countenance, you could get there.

The CHAIRMAN. Mr. Moynihan.

Senator MOYNIHAN. Mr. Chairman, I think the Secretary has been wonderfully responsive in clarifying his views, and I want to thank him.

I have one question in writing which I would like to give you on the President's proposal for a border service user fee. Perhaps you could get back to us on that.

Secretary RUBIN. We would be delighted, Senator.

Secretary Moynihan. Thank you, sir.

Secretary RUBIN. Thank you.

[The question appears in the appendix.]

The CHAIRMAN. Mr. Secretary, thank you. You have been very patient. We will see you often.

Secretary RUBIN. I enjoyed being here. Thank you, Mr. Chairman.

[Whereupon, at 11:55 a.m., the hearing was adjourned.]

# APPENDIX

## ADDITIONAL MATERIAL SUBMITTED

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### PREPARED STATEMENT OF ROBERT E. RUBIN

Chairman Packwood, Senator Moynihan, members of the committee, I'm pleased to appear before you to present the President's budget for fiscal year 1996. I am doing something not many Treasury Secretaries get to do: presenting a budget that continues a process of cutting the deficit begun at the start of the Administration and that cuts taxes and increases public investments both in ways designed to increase future productivity.

I am also doing something that you'd have to go back 16 Treasury Secretaries to the era of President Truman to find: showing a decline in the budget deficit for three years in a row—1993 through 1995.

What I'd like to do now is to summarize the longer statement I've submitted for the record.

President Clinton, from the very beginning of this Administration, has had a broad-based economic strategy to stimulate and then protect the recovery, to position the country for the long-term, and to increase the incomes of working Americans.

This strategy consists of fiscal discipline, boosting both private and public investment to increase long-run productivity, opening markets, reforming government and regulation, and achieving health care and welfare reform.

Our first move was to bring the deficit under control after a long period of large and increasing deficits and facing projections for large and increasing deficits going forward. Working with Congress, we enacted a powerful deficit reduction program. As a result, the deficit has come down from \$290 billion in 1992 to what we now project as \$193 billion this year. Or to use a starker contrast, from a projected \$400 billion in 1998, on the basis of the last budget numbers released by the prior Administration, to \$194 billion projected for the same year under this budget.

The deficit as a percentage of GDP goes from 4.9 percent in 1992 to a projected 2.7 percent for this year (Chart 1), and a projected 2.1 percent of GDP in the year 2,000. Fiscal discipline has been reestablished after a long period of ballooning deficits. The deficit has been reduced by more than one-half, both in absolute terms and as a percentage of GDP.

I worked in financial markets for 26 years, and I have no doubt that our aggressive deficit reduction program was, in large measure, responsible for the decline in interest rates in 1993, which in turn was key to jump-starting the economy in that same year. Rates have now increased reflecting growth but the deficit premium—that critical impediment to growth—is in my judgment largely gone.

We now have a strong investment-led recovery that's creating jobs. Business investment in machinery and equipment (Chart 2) has increased dramatically, and as a percent of GDP, is at an all-time high. That's a big plus for future productivity.

The economy has created 5.7 million jobs (Chart 3), 5.3 million in the private sector. The unemployment rate has declined from 7.1 percent to 5.7 percent.

And, even with the strength of the current recovery, the increase in the consumer price index has come in under 3.0 percent for each of the last three years.

In the long term, however, the success of our economy will depend on raising productivity growth. Productivity growth has been extremely slow for a generation, and this has contributed to slow growth in workers' incomes.

Slow growth in average wages has been accompanied by an unequal distribution of income gains. In the past fifteen years, those with incomes in the lowest fifth of American households have seen their real incomes fall; those in the top fifth have seen their incomes rise; and the middle has stood still.



This budget emphasizes a three part strategy to promote growth and improve the incomes of working Americans: (1) maintaining fiscal discipline, (2) providing tax relief for the middle class that is targeted to also promote individual activity that will increase future productivity, and (3) increasing public investment in workers through education and training.

#### MAINTAINING FISCAL DISCIPLINE

First, maintaining fiscal discipline. On a ten year basis, we project that this budget will reduce the budget deficit to 1.6 percent of GDP.

We continue reducing the deficit while lowering taxes at the same time by making substantial spending cuts in three areas.

Restructuring government saves \$26 billion, savings that come largely from five agencies—the Departments of Transportation, Energy, and Housing and Urban Development; the General Services Administration; and the Office of Personnel Management.

We save \$80 billion by further lowering the discretionary spending caps in 1996 through 1998 and extending them for two years beyond their scheduled expiration in 1998.

Thirty-two billion dollars in savings come primarily from the mandatory side of the budget through continuing some existing health care savings, imposing user fees for the electro-magnetic spectrum, accelerating the direct student loan program and reducing certain agricultural programs.

A remaining \$5 billion of deficit reduction comes primarily from lower debt service, as a result of our success in lowering the deficit.

All of these program cuts, projected debt service reductions, and other changes save \$144 billion between 1996 and 2000. The President has proposed using \$63 billion of these savings to provide tax relief to middle-income families as part of his Middle-Class Bill of Rights.

While the deficit is projected to continue to fall as a percentage of the economy for the next ten years, eventually the deficit will turn up. The problems are an increasingly aging population and rapidly rising health care costs. If we want to maintain fiscal discipline over the long run, we must reform health care as soon as possible.

Before I leave our deficit discussion, let me make two additional points.

Under President Clinton (Chart 4)—for the first time since the 1960s—expenditures on government programs are less than the taxes paid by the American people. In other words, our deficit results from the burden of paying interest on the debt accumulated primarily by the deficits of the 1980s.

The second general point I'd like to make is that I believe the way to achieve deficit reduction is through deliberate and thoughtful policy choices, not through a balanced budget amendment that substantially increases macroeconomic risk in our economy and involves spending cuts that have not been specified at the time the decision on a balanced budget amendment is made.

#### PROVIDING TAX RELIEF FOR MIDDLE-INCOME AMERICANS

Let me now turn to the centerpiece of the President's budget. On December 15, 1994 President Clinton announced his "Middle-Class Bill of Rights."

A middle-class tax cut has been an explicit goal of this President from the beginning. Many working American families have lagged behind—even in the last two years, when growth in the economy has been brisk. Not only do these tax cuts provide immediate relief to financially strapped middle income families but these tax cuts also serve an important economic purpose by helping these families save and invest to become more productive and enjoy higher future standards of living.

We've targeted tax reduction squarely at middle-income families (Chart 5). Eighty-six percent of the benefits of these proposals will go to families with incomes between \$20,000 and \$100,000.

First, the \$500 child credit for children under 13. This credit is designed to help younger families, where economic pressure often tends to be greatest, to provide better child care, after-school activity, and the other requisites for good child rearing. This credit, which is non-refundable, would reduce the federal income tax burden of a typical two-child family with an income of \$50,000 by almost 21 percent, once the credit is fully phased in. This is an investment in children—the future of our country.

Second, a \$10,000 deduction for post-secondary education and training expenses. This deduction can be used by all members of the family, including spouses and children, and will help middle-income families better obtain the education and skills

that will equip them to succeed at work in a modern economy—again, people investing in themselves.

Third, expansion of individual retirement accounts. This program will substantially increase the availability of individual retirement accounts by raising the income ceiling to \$100,000 for joint filers and to \$70,000 for individuals. Under the President's plan, the flexibility of the individual retirement account is greatly enhanced which we believe will increase use and thereby savings. An individual can either deduct the amount deposited up front, or forego this deduction in favor of tax-free withdrawal of all accumulated earnings after five years. Also an individual may save for a broader range of purposes: penalty-free withdrawals may be made at any time for specified purposes such as education, a first home, or certain medical expenses.

Finally, on the subject of taxes, one of the Administration's priorities is to implement fully the Internal Revenue Service's Tax Systems Modernization (TSM) plan to reduce the administrative burden on businesses and individuals and to raise compliance.

#### PUBLIC INVESTING FOR THE FUTURE

The President's many-faceted public investment program, critical to future productivity, will focus on his "G.I. Bill for America's Workers," which consolidates and streamlines a patchwork of some 70 job training programs to provide skill grants to lower-income and displaced workers.

#### COMMENTS ON THE CONTRACT WITH AMERICA

You asked me to comment on the Contract with America, so let me do that now. One of our primary concerns with the tax cuts in the Contract is their potential effect on the deficit.

We have prepared preliminary revenue estimates of the tax provisions in the Contract based on the bills introduced on January 4, 1995. These preliminary revenue estimates show that the tax cuts proposed in the Contract would lose \$205.4 billion over the period FY 1995—FY 2000. The revenue cost grows rapidly after FY 2000, to nearly \$120 billion per year in FY 2005, raising the FY 1995—FY 2005 revenue cost to \$725.5 billion. Joint Tax Committee estimates published on Monday are similar to ours.

Although the Contract proposes a balanced budget amendment, it does not contain specific proposals for expenditure reductions or tax changes necessary to achieve that balance. Nor does it offset the proposed tax cuts or pay for other provisions, such as increased defense expenditures, that would further increase the deficit. Thus, the tax provisions in the Contract would increase the deficit unless they are fully and permanently offset by specific financing proposals.

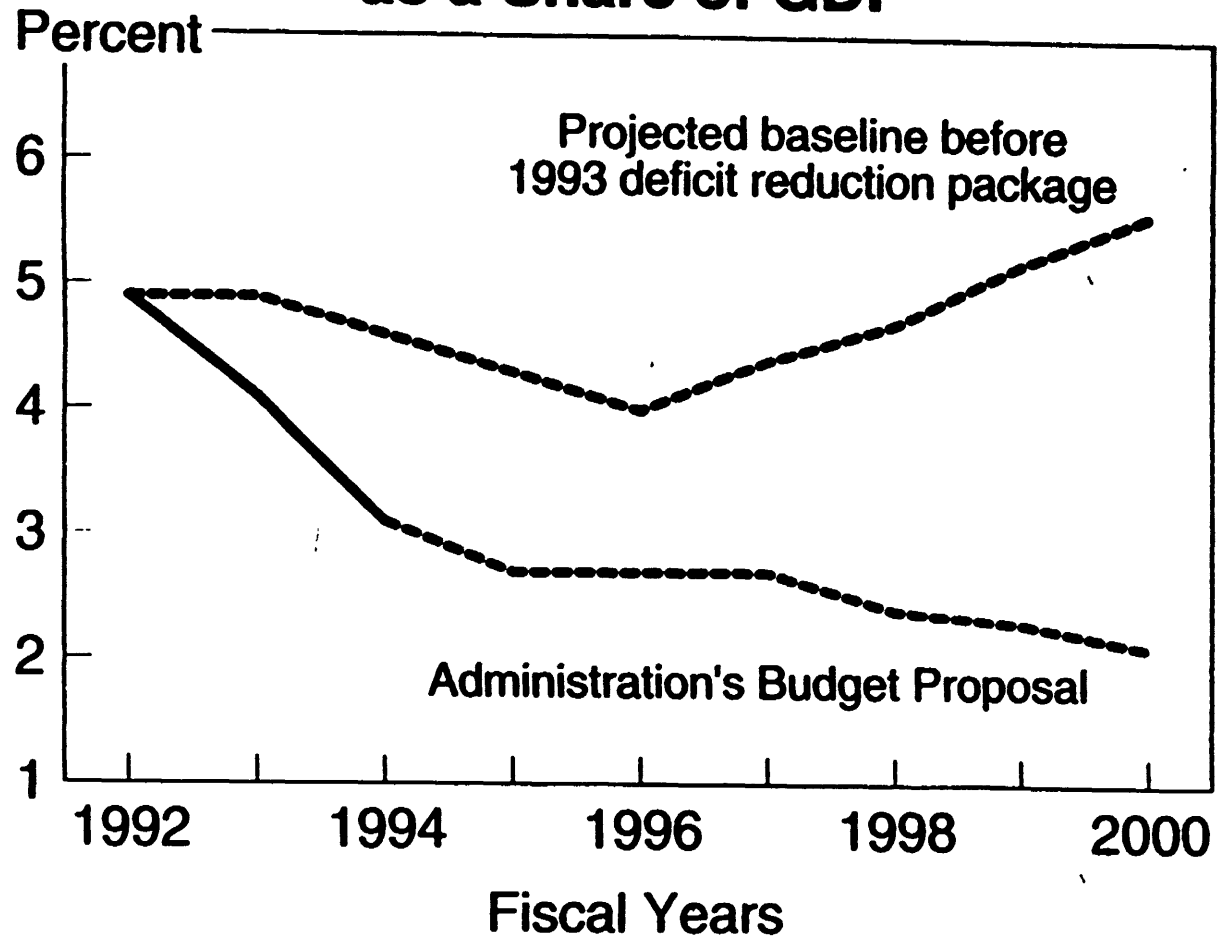
Moreover, several of the proposals of the Contract, particularly the indexing of depreciation deductions and the capital gains indexing proposals, could create very serious problems. We predict that if these provisions are enacted, our nation will experience the equivalent of the tax shelter days of the 1980s. Most of the obvious opportunities in the Contract arise from the fact that assets would be indexed, while debt would not. Put simply, artificial tax deductions will be created with little or no out-of-pocket cost. We expect that these abuses will be widely marketed and could substantially reduce any tax on capital gains. Also, these indexing proposals will create significant complexity for taxpayers and the Government.

#### CONCLUSION

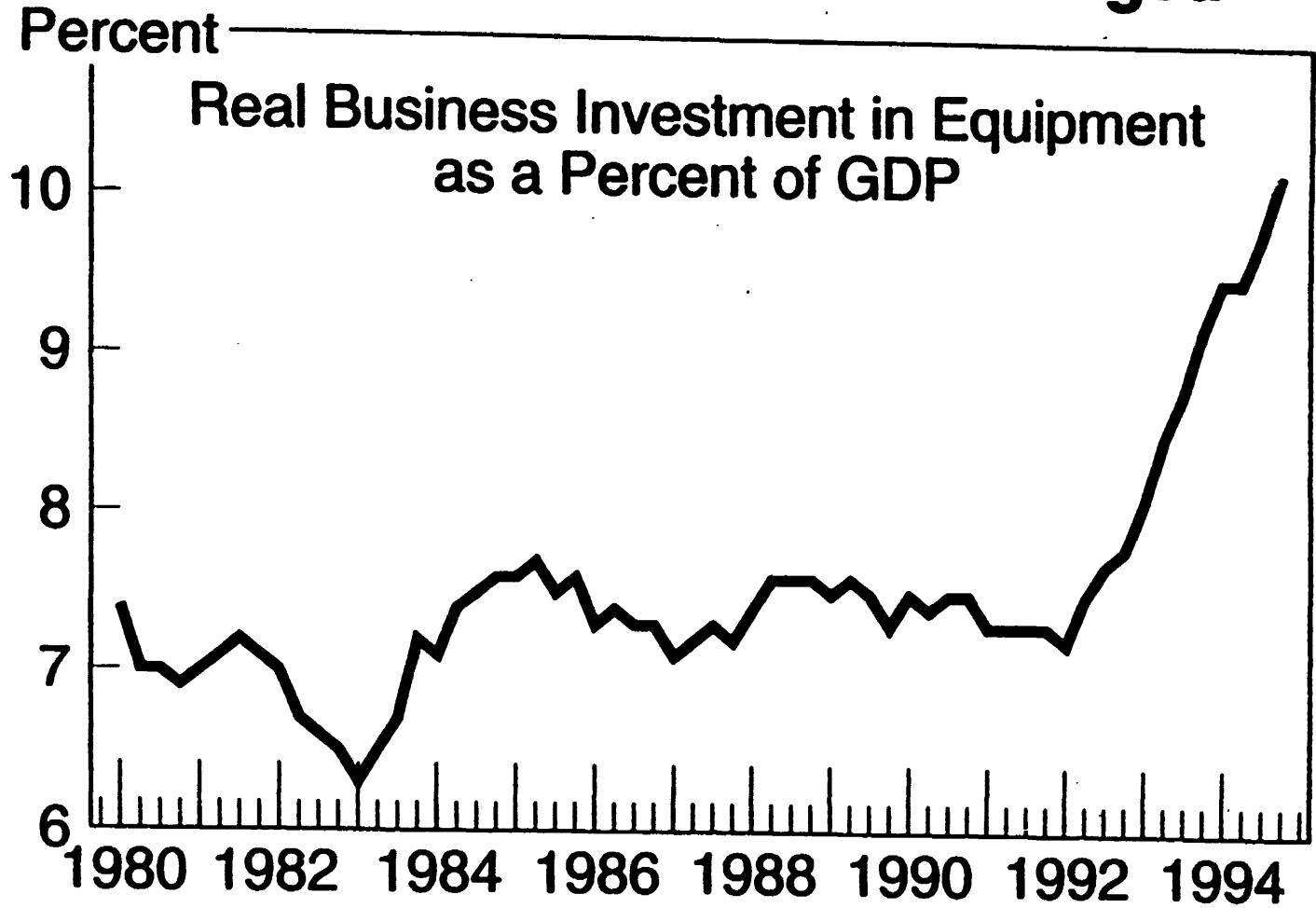
To conclude, this budget is the next step in carrying forward the President's economic strategy designed to raise the living standards for all Americans.

Much has been accomplished in the past two years, but much remains to be done. I welcome the opportunity to work with you on a bi-partisan basis to continue moving forward.

# The Deficit Has Been Cut in Half as a Share of GDP

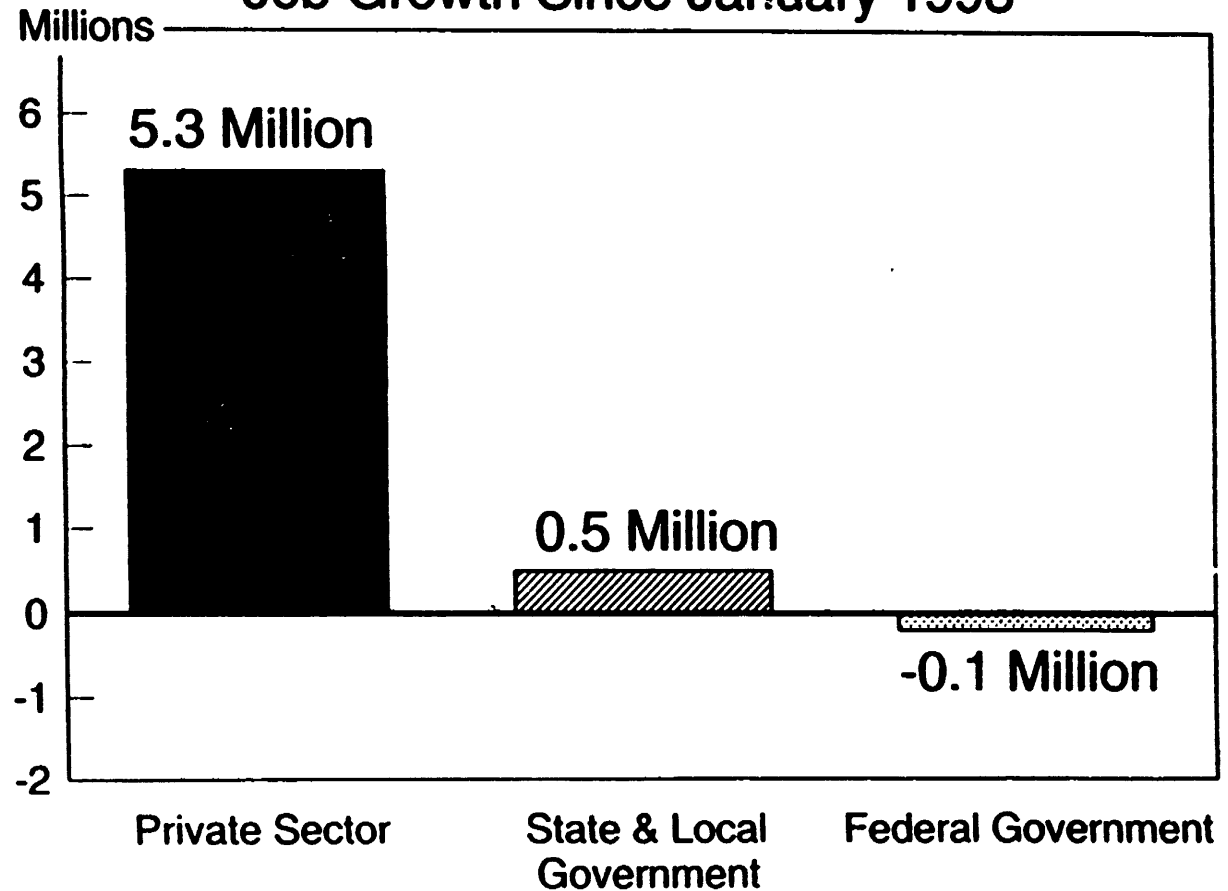


# Business Investment Has Surged



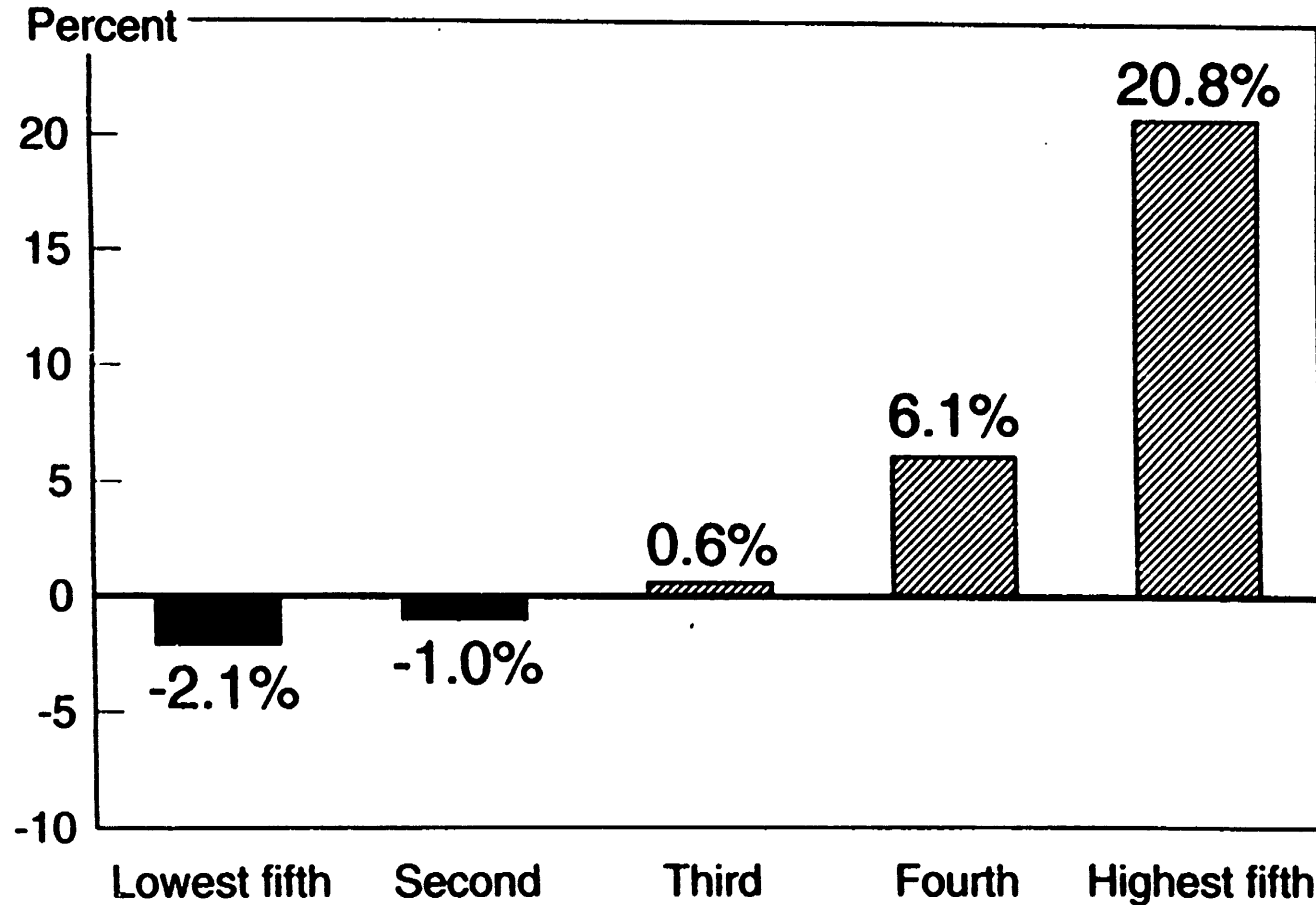
# 93 Percent of the 5.7 Million New Jobs Have Been in the Private Sector

Job Growth Since January 1993



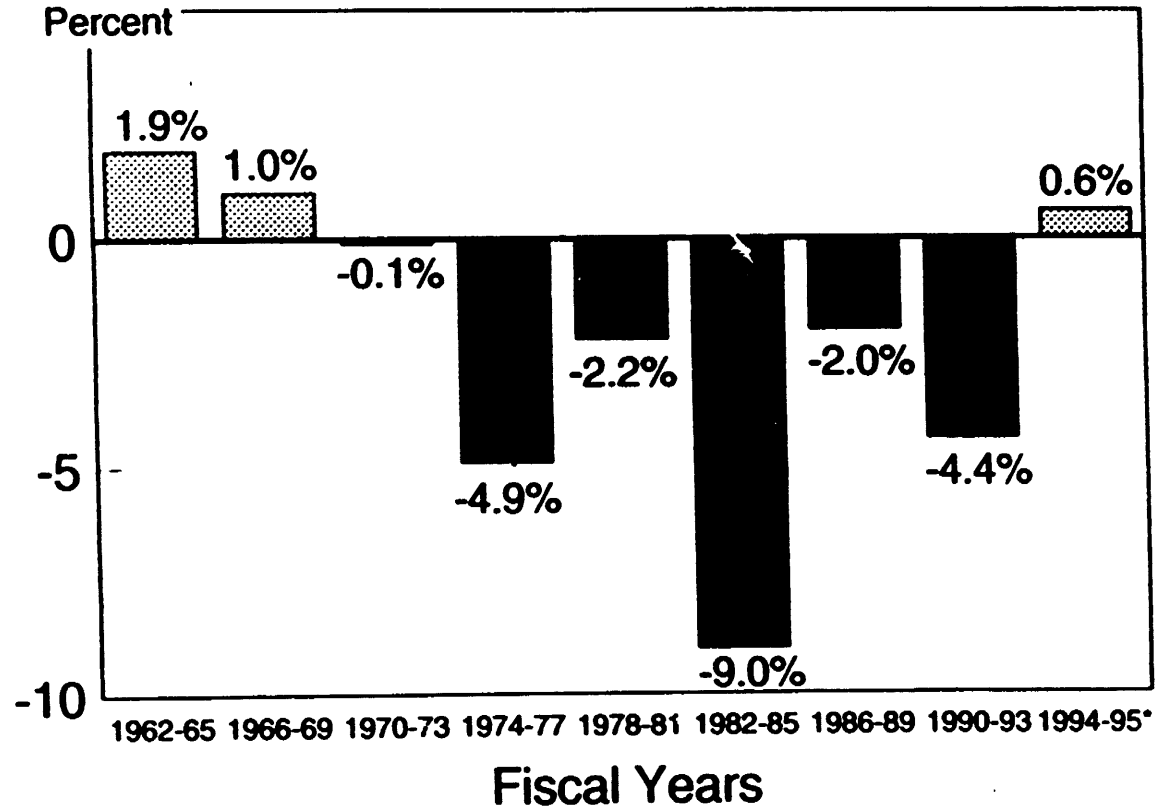
# Middle Class Incomes Were Stagnant, 1980-93

Change in Average Real Household Income



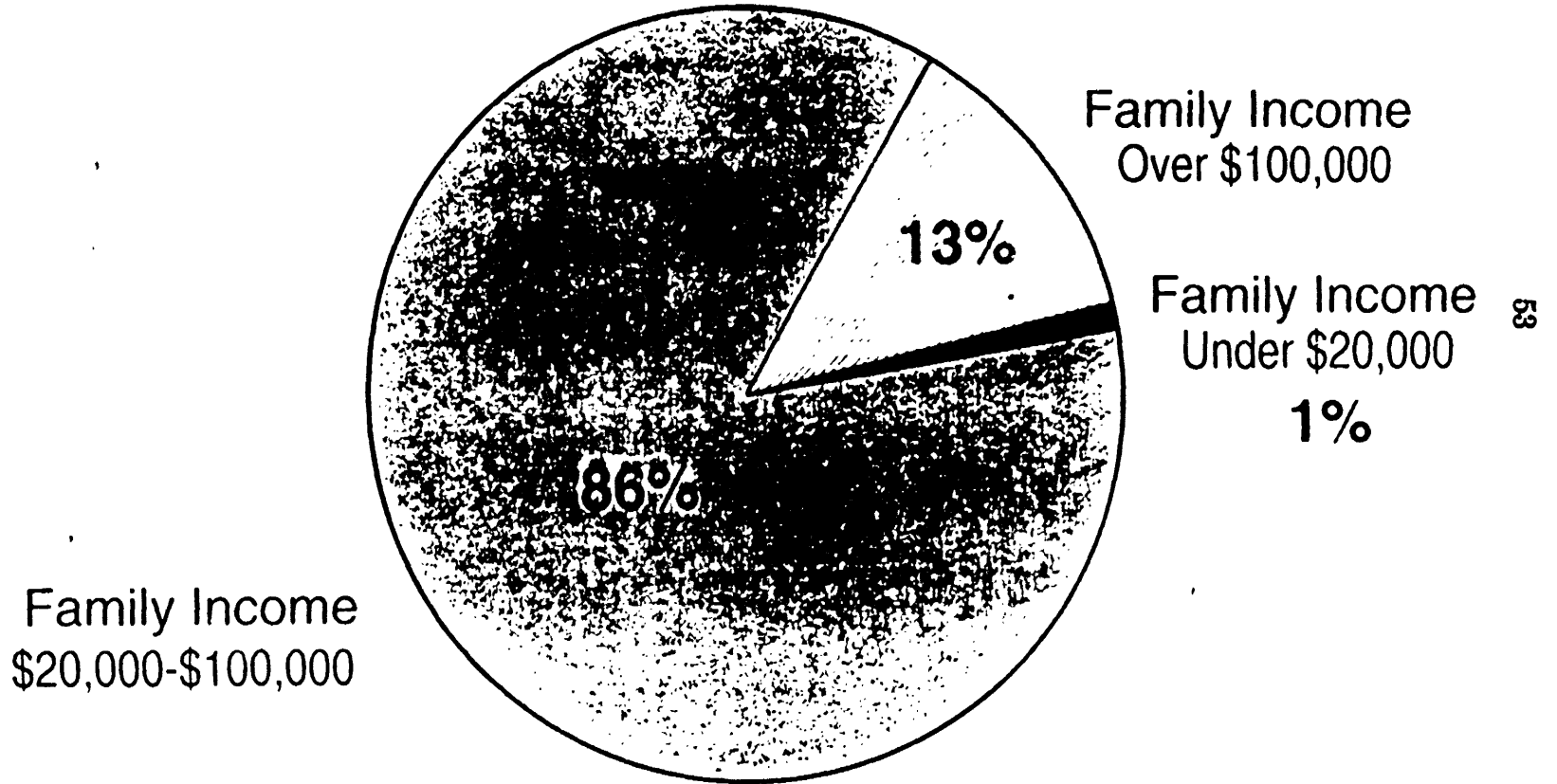
# Spending on Government Programs Is Less than Taxes for the First Time Since the 1960's

## Revenues Minus Program Spending as a Share of GDP



\*Fiscal year 1994 and projection for fiscal year 1995.

# Tax Cut Targeted to Middle-Income Families





## COMMUNICATIONS

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### STATEMENT OF THE TELEPHONE AND DATA SYSTEMS, INC.

This statement is being submitted by Ross J. McVey, Assistant Controller, Telephone and Data Systems, Inc., P.O. Box 628010, Middleton, Wisconsin 53562-8010 (608-828-8314). Telephone and Data Systems, Inc. ("TDS"), is pleased to have this opportunity to submit this statement concerning select tax provisions contained in the Contract With America (the "Contract"). TDS is one of the largest independent communications providers in America, employing over 4,700 people in 45 states through its telephone, cellular, and paging operations. The communications industry has and will continue to play a major role in the economy of this country. This is a highly capital-intensive industry, one which consistently advocates federal tax policies that lower the cost of capital and provide needed incentives to implement new technologies.

TDS supports the underlying precepts of the Contract, those being the lessening of the role of government through lower taxes, less spending, and the promotion of jobs and the economy through capital formation. To that end, we have focused our comments on the following two Contract proposals within the Committee's jurisdiction which are of primary importance to TDS, its employees, and its customers: The Neutral Cost Recovery System and the Capital Gains Exclusion.

#### NEUTRAL COST RECOVERY

The Neutral Cost Recovery System ("NCRS") contained in the Contract contains many positive aspects that will help achieve the desired goal of capital formation. The increase of depreciation deductions to reflect the effects of inflation and the time value of money coupled with not reducing the tax basis of the subject property by the indexed factors will depreciate the property in a manner that more accurately reflects a company's true economic investment.

TDS supports the extension of NCRS to the depreciation component of the alternative minimum tax ("AMT"). The failure to do so would destroy the parallel nature of the regular and AMT tax systems and would accelerate the cash flow requirements of AMT taxpayers, offsetting the incentives of NCRS.

For taxpayers subject to regulation, such as our telephone operations, the benefits of NCRS must be normalized. This is especially true due to the back-loaded benefits of NCRS. Otherwise, the intended benefits may not accrue to the taxpayer. Rather, regulators may pass the benefits on to ratepayers immediately rather than over the life of the property.

A concern of TDS with NCRS, as presently structured, is that the provisions do not evenly apply to certain industries and property. The proposal's 3.5 percent time-value-of-money adjustment would only apply to property with a class life of 10 years or less. This could have the effect of discouraging investment in long-lived property, which can account for up to 35 percent of the annual investment made by TDS and other telephone companies. Failure to include long-lived property, as eligible for the 3.5 percent adjustment, could also cause some unintended distortions in competitive behavior.

As noted above, a significant portion of TDS's investment is in long-lived property. The different treatment accorded long-lived property is inequitable in that many of the current and future competitors of telephone companies are permitted to recover their investments in the same type of property over seven years, versus the 15 years required for telephone companies.

With regard to applying the provisions, we support the flexibility of allowing the NCRS election to be made on a property-by-property basis. We do feel the election to utilize NCRS should be affirmative, rather than requiring an election to decline, as currently drafted. Additionally, the requirement of applying the indexes on a

quarterly basis will add cost and time to comply with these rules. The use of an annual index would provide for ease in compliance and still achieve the objectives of the legislation.

#### CAPITAL GAINS

TDS is a strong proponent of the proposed 50 percent exclusion of capital gains, as well as the indexing of capital gains for inflation. Investors and businesses should be taxed only on real economic gains resulting from their capital assets and not on inflationary gains. The proposed exclusion and inflation adjustment allow investors to retain more of their investment, lowering the cost of such capital. This affect of both provisions is multiplied in that they would encourage greater investment in the new technologies needed to allow our economy to compete in today's global markets

The concern over the requirement of using a quarterly index as stated above for NCRS is applicable here also. This provision would be burdensome for the typical investor.

#### FEDERAL REGULATIONS

We would like to express and encourage caution in considering the impact of a proposed moratorium on federal regulations. Specifically, we would ask that, in the event this is considered, there be an exemption for tax regulations published by the Treasury Department. These regulations are needed to provide taxpayers a semblance of confidence in dealing with the complexities of the tax law. A moratorium would likely have the effect of increasing individual letter rulings, taxing an already overburdened Treasury staff.

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We would like to congratulate the authors of the Contract for their boldness and vision in seeing the true needs of this economy, and the need to spur capital investment. TDS, as a communications player on the "Information Superhighway," realizes the need for the investment upgrades, and would encourage your efforts in proposing tax legislation to that end.

Thank your for this opportunity to present testimony. We would be pleased to discuss these items with members and committee staffs at their convenience.

