S. HRG. 105-796

ADMINISTRATION'S FY 1998 BUDGET AND REVENUE PROPOSALS

HEARING

BEFORE THE

COMMITTEE ON FINANCE
UNITED STATES SENATE

ONE HUNDRED FIFTH CONGRESS

FIRST SESSION

FEBRUARY 12, 1997

Printed for the use of the Committee on Finance

U.S. GOVERNMENT PRINTING OFFICE

52-443—CC WASHINGTON : 1997

For sale by the U.S. Government Printing Office
Superintendent of Documents, Congressional Sales Office, Washington, DC 20402
ISBN 0-16-057940-6

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ADMINISTRATION'S FY 1998 BUDGET AND REVENUE PROPOSALS

WEDNESDAY, FEBRUARY 12, 1997

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

The hearing was convened, pursuant to notice, at 10:03 a.m., in room SD-215, Dirksen Senate Office Building, Hon. William V. Roth, Jr. (chairman of the committee) presiding.

Also present: Senators Grassley, D'Amato, Murkowski, Lott, Moynihan, Baucus, Rockefeller, Breaux, Conrad, Graham, Moseley-Braun, Bryan, and Kerrey.

OPENING STATEMENT OF HON. WILLIAM V. ROTH, JR., A U.S. SENATOR FROM DELAWARE, CHAIRMAN, COMMITTEE ON FINANCE

The CHAIRMAN. The committee will please come to order. Secretary Rubin, it is a pleasure to welcome you today. I know you are a little bit under the weather, so, as I said, we will try not to be too hard on you.

Well, we are here to discuss the tax proposals contained in the President's budget. The President, in his State of the Union address last week, promised the American people a balanced budget that invested in our people.

He promised middle-class tax relief, as well as tax incentives, in the private sector to promote jobs, opportunity, and growth. These objectives are included in the fundamental priorities of this committee, and I am encouraged by the President's movement in this direction.

I am particularly encouraged by his proposal to cut taxes for American working families, families that are today paying more to State, local, and Federal Government than they are for food, clothing, and housing combined. This is not right. I am pleased to see that the President's budget shows common ground with Republicans in doing something for these families.

I am pleased to see that the President is calling for family tax relief. I am pleased to see that he is supporting our long-time and ongoing efforts to create and expand Individual Retirement Accounts, IRAs that will allow American families to save and to work towards self-reliance in retirement.

The President calls for a capital gains tax cut of a limited source. That is something that has found strong support in Congress, and among Americans. Likewise, I am pleased to see in his budget that he has been moving on to common ground when it comes to providing measures to help parents and students cope with the high cost of education, something of considerably interest to my friend and colleague, Senator Grassley.

Again, as I said, this is something that we have been working on for some time now. In the late 1980's, Senator Lloyd Bentsen, your predecessor and I, proposed expanding IRAs in a way that would allow parents, children, and even grandchildren to work together to meet the increasing price tag on higher education. This is critical to our future.

While I find reason to celebrate the common ground, I realize that there are some very, very significant differences, sometimes serious differences, but at least we are in agreement on the goal of tax relief.

One of the most disconcerting differences to me is the fact that the President is willing to sunset some tax relief measures in his proposal, but opts for higher government spending if budget discipline is not maintained. This has the effect of punishing American families for Washington's inability to control spending, and to me that is not acceptable.

American families must know, when they are given expanded IRAs or tax deductions, credits for higher education, that these are changes that they can count on. Doing otherwise undermines incentive, stifles careful financial planning, and reeks of politics.

On a final note, even though the President's budget recognizes the need for an accurate CPI, I am disappointed that it does not contain a proposal to correct it. I hold out considerable hope that you will be a leading advocate for improving this most critical, important government statistic.[1]

Senator Moynihan?

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

Senator MOYNIHAN. Thank you, Mr. Chairman. Welcome to Secretary Rubin and Mr. Lew. We are aware that you made a one-day trip to Berlin, with not the happiest aftermath. But it must have been a pleasant meeting for you. That is a wonderful way to put it.

Until recently, you say we, the United States, were viewed as yesterday's economy, and now we are, once again, the super, stuper-mundi, as I guess the old Romans would say. We are the world's economic leader. We are in our 77th month of an expansion, which would make it the third longest in the post-World War II history.

Who knows what it will become? It could become the longest, with time. It is a remarkable performance. You are so intimately associated with it. I hope you take what pleasure you can, despite influenza, and we look forward to your testimony.

If I could just add to the Secretary's comments about the cost of living index. We had excellent testimony yesterday from Katherine Abraham, the head of the Bureau of Labor Statistics, in which she

[1] For further information on this issue, *see* Joint Committee on Taxation document: JCX-6-97R—*Description of Revenue Provisions Contained in the President's Fiscal Year 1998 Budget Proposals*, February 10, 1997.

very candidly and openly asked, with more resources the BLS can more quickly come to a new market basket and bring matters up to date. But she also said, and this is so important, that the CPI is, as she put it, the upper bound of an estimate of cost of living, and there is a lower bound, and somewhere in the middle there is probably a reasonable judgment.

That is what this committee has heard. We have certainly heard very powerful testimony from Alan Greenspan, who proposed a commission that, starting with that upper bound, would then make a judgment on a final index number. That seems to us doable. In any event, it is an idea very much in play. Welcome again, sir.

The CHAIRMAN. Mr. Secretary, we would now be pleased to hear your opening remarks.

STATEMENT OF HON. ROBERT E. RUBIN, SECRETARY OF THE TREASURY, WASHINGTON, DC

Secretary RUBIN. Thank you, Mr. Chairman. I appreciate the opportunity to be here to discuss the President's 1998 budget. Mr. Lew and I would both be delighted to respond to questions afterwards.

Senator Moynihan, we did have an interesting day in Berlin. I do not think I would recommend one-day trips to Berlin. But it was, indeed, interesting. I can remember not terribly long ago, five, 6 years ago, when our leaders went to G–7 meetings and we were viewed as not facing our problems and, to use the phrase that you quoted me as having used, as yesterday's economy. Indeed, I think we were so viewed.

The atmosphere is really very different today. We are viewed as a Nation that has faced its challenges, both in the private and in the public sector, particularly in the public sector on the question of fiscal discipline.

We are, without question, viewed once again as the world leader. In fact, I would say viewed as the only country in the world that can really provide effective leadership on the issues of the global economy.

The discussion in Berlin was interesting in another respect, too, as we broadened out and discussed the broader questions of our respective economies.

The issues we discussed were not very different than the issues that the President discussed in his State of the Union: how do we educate our work forces for the global economy; what do we do in our respective countries about the least well-off and giving them the skills to enter the economic mainstream, and what are the productivity losses that are involved in their not being part of the economic mainstream; and then how in each of our countries do we deal with the tendency to look inward, to try to pull back from the global economy, so that each of our countries can continue to participate effectively and provide leadership in dealing with the issues of a global economy, particularly the United States, which, as the President so often likes to say, is without question the indispensable Nation in today's world.

Coming back, my sense was that we really do have an extraordinary opportunity to build on the great progress that has been made in the last years, both in the private and the public sector, and to position ourselves very effectively for the century to come.

But it does require that we continue with fiscal discipline, it does require that we continue with the kinds of programs that would produce increased productivity in our own country. That is what the President's State of the Union address was about, that is what the budget is about. With that, let me, if I may, turn to the budget for a few moments.

We are within striking distance of achieving balance and that would not have happened without the progress of the last 4 years. At the beginning of that four years, the deficit was 4.7 percent of GDP, it is now 1.4 percent of GDP.

That deficit reduction, in turn, inspired broad business confidence, drove down interest rates, and the combination of lower interest rates and business confidence have, in our judgment, been the key factor in the favorable economic conditions of the last 4 years.

I might add that, of the G–7 Nations, we have, as I said a moment ago, the lowest deficit to GDP ratio, and far and away, taking all into consideration, the most favorable economic conditions. I do not think that those are unrelated events.

This is, in our judgment, an historic opportunity to continue the job and to go to balance. There is strong support amongst the public for having a balanced budget. I believe that there is a change of attitude in Washington, and I think that reflects itself and the budgets that the President and the Congressional Majority have put forward over the last couple of years. Moreover, there is a new factor at work which, in our judgment, will enforce fiscal responsibility around the world in the years to come, and that is global financial markets.

I do not think there is any question but that the global financial markets are intensely focused on the state of a Nation's fiscal responsibility, and that the global financial markets will punish fiscal laxity with high interest rates, which, in turn, are inimicable to economic growth. So I believe that we can, we should, and we must work together to get this job done and get it done now.

The President's budget takes us to balance by 2002. It does so with prudent, realistic numbers, exactly the kinds of numbers we have used the last 4 years, in each of which the deficit has come in under our projections and it does so with sound policies, while at the same time protecting the priorities I mentioned a moment ago, of investing in people and promoting productivity in the years to come.

I can well remember when I was on Wall Street and we would see budget after budget, we would do our analysis, and we would put out little reports saying that these budgets were built on grains of sand because they were built on rosy projections that could not possibly produce the results they promised.

That is exactly what happened. Year after year, the deficits came in higher than had been projected and little progress, if any, was made toward fiscal responsibility.

When the President took office he rejected that approach and he insisted we have sound numbers. We have had sound numbers and the results speak for themselves.

I believe, by the way, that the results that we have had, the deficit coming in under projections 4 years in a row, is almost surely unprecedented in budgetary history.

I believe that it should give us all confidence in the spirit in which the 1998 budget was put together, because that budget was put together with the same approach to numbers and policies as the budgets of the last 4 years.

Our budget makes tough choices. It eliminates 254 programs outright, for $2.9 billion in savings. We went through the discretionary accounts, non-defense discretionary accounts, in each of the agencies in order to make sure that we eliminate all spending possible that was consistent with achieving the objectives and the purposes of the agencies. We have auctions of broadcast spectrum.

We have proposals to close corporate loopholes, to eliminate no longer warranted subsidies, to improve compliance. We cut Medicare by $100 billion. We have a per capita cap on Medicaid. In many other respects, we made the tough choices that have resulted in and lead to a sound and sensible budget.

In the absence of change, the Part A trust fund is currently estimated to expire, or to exhaust, I should say, in the year 2001. The President's proposal extends the exhaustion date to the year 2007.

At the same time, as the President said so often, there are clearly long-term entitlement problems, long-term entitlement issues, the kind that were addressed in Senator Kerrey's commission, that this Nation is going to have to deal with.

Those issues were not dealt with in the Congressional Majority's budgets in the last 2 years, they were not dealt with in the President's budgets of the last two years. They need to be dealt with in a true bipartisan process. The President has called for that on frequent occasions.

In our judgment, those are the kinds of processes that need to be set up to deal with the issues beyond the issues that we are dealing with in this budget and this budget window.

Let me also say, Mr. Chairman, as the President said in his State of the Union address, while we are deeply committed to balancing the budget and absolutely convinced that fiscal health is central to our Nation's economic health, we are equally convinced that a balanced budget amendment would subject our economy to unacceptable risks in perpetuity, would create additional risks for Social Security, and should not be adopted.

We also do not believe it is necessary to get to balance. And, as I said several times already, we believe that the opportunity is here now, that we should take that opportunity, and we will, in fact, put in place balanced budget legislation this year.

Within the context of moving toward a balanced budget, it is extremely important that we invest in areas critical to future productivity and to the United States global leadership. This budget addresses those issues in many ways. Let me just touch on a few that are tax-specific, plus a few other items that are of particular concern or particular interest in this respect.

The budget contains a program of tax cuts directed toward middle-income people to better provide the opportunity for middle-income people to obtain the skills they need to prosper in the modern economy, to increase savings, and to better enable hard-pressed middle-class families to provide adequate child care.

It also has programs specifically directed to the questions of helping people move from welfare to work, and to helping move the residents of distressed areas in our country, urban and rural, into the economic mainstream.

In addition, the administration is proposing to eliminate capital gains taxes on home sales for all homes where the sale results in a profit of less than $500,000.

Before proceeding to discuss other elements of the program, other specifics, let me stop for one moment to discuss the size of the tax cut. The President is proposing tax cuts totaling $100 billion over 5 years. We believe that strikes the correct balance between advancing the goals of a balanced budget and, at the same time, providing what we believe is merited and useful tax relief.

We believe the tax cuts that are much higher than the President has proposed cannot be accommodated in a balanced budget without making cuts in other programs that we believe would have adverse impacts on our society or our economy, and that would create undue harm disproportionate to the benefit of the additional tax cuts.

In many areas, the Congressional budgets of the last 2 years and the Congressional budget are reasonably close. That is not true on taxes. We have to work to close this gap. But what we must not do, in our judgment, is to engage in a bidding war over tax cuts.

Let me now, if I may, return for a moment to the President's proposals that deal with the critical areas of future productivity and promotion of economic health.

We propose extending the R&D tax credit for another year. We propose substantial additional spending on education and training, as well as the education deductions and credits that I have already mentioned.

We propose new efforts to ensure health care for children, new initiatives to encourage businesses to hire former welfare recipients, and, as I mentioned a moment ago, more generally, to help move the residents of inner cities into the economic mainstream.

I particularly chose to focus on the programs with respect to Welfare to Work and the more general questions of moving the residents of the inner cities into the economic mainstream because, while these are social issues, I think they are also absolutely critical economic issues.

One of the interesting discussions we had at the G–7 was the enormous losses in productivity that result when you have economically disenfranchised portions of your population and the enormous benefits that can be obtained if you can find effective ways of ending that disenfranchisement, empowering these people economically, and making them part of the productive work force. This President's budget has many programs that are designed to achieve those purposes.

Let me, if I may, mention one final area in this budget. That is the question of providing adequate resources to maintain United States leadership in the global economy. This budget seeks a significant increase in overall funding to sustain our international engagement and our role, as the President says, as the indispensable Nation.

As I mentioned a moment ago, one of the things that most struck me—maybe the thing that most struck me, actually—at the G-7 meeting this past weekend in Berlin was, one, how well we have done as a Nation economically over the last several years through the efforts of both the private and the public sector, but, second, how we are the only Nation in the world that can provide true leadership for the global economy.

But if we are going to do this, and if we are going to continue to maintain our position to shape the global economy in ways that are consistent with our beliefs in market-based economies and in ways that are consistent with our interests, then we must meet our commitments to the international organizations: the United Nations, the World Bank, its sister banks, the International Monetary Fund.

If we do so, then we can continue to have what I think is an enormously important role, enormously important in terms of our economic and our National security self-interest in shaping this global economy that we are all integrally a part of. We should do this, not for charitable reasons, but because, as I just said, it is in our economic and national security self-interest to do so.

Mr. Chairman, let me conclude by saying that I believe we have an historic opportunity to complete the job that we began in 1993 and now go, having reduced the deficit by about 60 percent, the rest of the way to balancing the budget.

I believe we need to do so in a way that promotes the areas that are critical to future productivity, future economic growth, and a healthy society. Let me conclude by again thanking you for giving me the opportunity to discuss the President's budget. Jack Lew, our Deputy Director of OMB, and I would be delighted to respond to your questions. Thank you, Mr. Chairman.

The CHAIRMAN. Thank you, Mr. Secretary. We are very pleased to have our Leader here this morning. I would be happy to yield to you, if you would care to proceed.

Senator LOTT. Thank you very much, Mr. Chairman. I know we have got quite a line-up of distinguished Senators here, senior Senators, so I do not want to take advantage of the opportunity you have given me. But, since I have not had that opportunity before, I do not want to pass it. [Laughter.]

Senator LOTT. Just a couple of questions, if I could, Mr. Secretary. Thank you very much for being here. I am hoping that we can get some early work going, aside from the budget discussions, on the tax component itself.

It is very important, and I think sometimes we get the tax policy so tied up in the budget discussions that we lose sight of the impact of the decisions we are making on tax policy because of the needs on the spending side are not the spending side.

Let me just ask you a couple of questions. We had a good deal of discussion yesterday with the President about this Welfare to Work tax credit. We did not get into any specifics at all. Just briefly, can you give me some idea of how you think that would work, and what would be the cost impact?

Secretary RUBIN. Yes. I remember the discussion that you all had at the leadership meeting yesterday. The basic idea is that we are going to now being moving large numbers of people off welfare to work, because of the program that you and the President agreed on last year.

The question is, how do we provide job opportunities for all of these people who are going to be moving off of welfare? The idea of this tax credit is to provide a rather substantial incentive, actually, to private sector employers to hire people who have been long-term welfare recipients by giving them a credit, tax credit, for 50 percent of the first $10,000 of wages, on an annualized basis. They can do that for a period of 18 months.

Our hope is that that will produce a real incentive on the parts of employers to proactively seek to hire people who are coming off welfare. It is also our belief that the solution, or the resolution of the question of moving people from welfare to work, should like in a private sector-induced process rather than in the public sector.

Senator LOTT. Do you have a cost estimate?

Secretary RUBIN. Yes, I can get it for you if you give me one second. I will have to find it. Over what period of time?

Senator LOTT. You choose. One year, 5 years.

Secretary RUBIN. This is about a half a billion dollars over 5 years.

Senator LOTT. Now, you have a number of suggested revenue raisers, tax increases, modifications of the Existing Tax Code that might yield some additional revenue. There is a pretty long list of them. Can I ask you to maybe just highlight a couple of the ones that you think would produce the larger amount of revenue and explain how that would work?

Secretary RUBIN. Sure.

Senator LOTT. I mean, you have got them in the corporate tax reforms area, foreign provisions, provisions relating to financial products. One concern we have got to have with this, is how much of a negative impact, if any, will this have on the capital formation. A lot of these taxes are going to affect the area that you came from, so I think maybe you had some inside word on how these tax considerations have been used.

So, if you would just maybe cite a few of those, I would be interested in hearing your explanation.

Secretary RUBIN. Mr. Leader, I am familiar with these from the other side of the table. They break down into categories. In terms of financial products, I do not believe any of those have an adverse effect on capital formation.

In fact, while they may have a positive impact in the sense of, they will avoid inefficiencies in terms of allocating capital, because what Wall Street tends to do—and I used to do a lot of it, and I was very good at it—was to take available capital resources and then try to use it in ways to minimize taxes. That results in distortions from what you would get if you had what you call a tax-neutral environment. A good example, would be shorting against the box to prevent realizations.

Senator LOTT. That is why I wanted to ask you about that.

Secretary RUBIN. Right.

Senator LOTT. Most Americans and most members of this committee, probably, do not have any idea what that is. I would like to know a little bit more about what it is, and what kind of revenue you are talking about being produced by that.

Secretary RUBIN. Sure. What it basically is, if I have got an asset that has run up in value and I basically want to avoid further risk and I am willing to give up further reward, then one thing I can do is just sell it, take my profit, pay my tax, and go home.

But if I do not want to pay the tax at the same time I do not want to be at the risk of that asset anymore, another thing I can do is sell an equivalent asset against it that is subject to exactly the same risks and rewards, so that if something then happens that affects the asset that I own, there will be an equal and offsetting effect on the distinct asset, then I have engaged in what is called short selling.

Senator LOTT. Do you understand that, John?

Secretary RUBIN. Senator Breaux, with all due respect, that was a simplified explanation. But I can get into the specifics.

Senator LOTT. What kind of money are you talking about?

Secretary RUBIN. What did we say for that, do you know? I have got all this in the charts someplace. We save about $1 billion over 5 years. But, you know, you do something else, Mr. Leader.

If you did not save a nickel, I think this is something we should do. One of the problems is, when you allow these kinds of distortionary mechanisms to exist, then they absorb a lot of capital that would otherwise be put to productive uses. We do, in fact, save about $1 billion over 5 years, but I think it should be eliminated even if we save nothing.

Senator LOTT. Well, we will not have time here today to go through your whole list. I think that is a list that I would hope that you would sit down with the Chairman and the Ranking Member soon and go over the whole list and talk about what the real impact is going to be, and what the costs are, because that also affects what we can do in a lot of other areas.

Secretary RUBIN. Could I just make one more comment on that, because I think you raise a very important philosophical question. Part of the purpose here was to save money, but part of it was really driven by something very different, which is, ideally, what you want is to, as you well know, allocate the Nation's available supply of savings in the most efficient way possible to produce the greatest possible growth in our economy, GDP.

When you get distortions, when the Tax Code distorts the use of capital, you then get a less efficient use of capital and the available supply of savings you have is less affected in economic growth.

So a very important motivation in all of this was to remove these distorting effects on the allocation of capital. We would be delighted to sit down with the Chairman and the Minority Leader, and whoever else is interested, and go through these one by one.

Senator LOTT. Just one final question. The President has indicated some interest in making some changes in the capital gains tax. Wait, wait. Let me finish my statement.

Secretary RUBIN. Oh, I was just looking interested.

Senator LOTT. Well, he has a proposal. The Senate Democrats have been home, and they talk to farmers, and small business men and women and they are saying, hey, this is not just for the so-called rich guys on Wall Street, this is also something that would help us on our farms out here and our small businesses.

So, while I do not know all of the details of their proposal, they have it in their package. So it looks like we are beginning to get our lips finally wrapped around the idea that maybe some relief in the capital gains tax area would be positive. Do you think, Mr. Secretary, that we could get some positive action, some agreement, on significant capital gains tax rate cuts or tax changes this year?

Secretary RUBIN. Well, we put in place in 1993, as you know, a targeted capital gains tax cut to favor small businesses and patient holders. If I remember correctly, there was a 5-year holding period, market value less than $50 million, and you had half of the regular capital gains tax rate. That would help a lot of small business owners. We put in this proposal the home owner capital gains tax exclusion which you mentioned.

Beyond that, Mr. Leader, we looked very carefully at the scarce resources we felt were available for tax relief, and we have our priorities, and you know what they are. We think they best serve the interests of our economy and the American people.

You and I have discussed capital gains before, and we may have somewhat different views of the effect that could happen in economic growth, but I think we have made the right judgments.

Senator LOTT. You left room then for there to be more discussion about that. Thank you.

Secretary RUBIN. Well, I did not either leave room or not leave room, I just stated our position, without prejudice either way.

Senator LOTT. I appreciate the courtesy, Mr. Chairman, and all the members. It is an honor for me to serve on this committee with these distinguished Senators. Thank you for letting me ask a few questions.

The CHAIRMAN. Thank you, Mr. Leader.

Let me go back to the first question the Leader raised about tax credit for the hiring of long-term people on welfare. Why is that not corporate welfare?

Secretary RUBIN. Well, Mr. Chairman, let me start by saying the term corporate welfare is not a term I have ever used, and I actually find rather unattractive. But, if you are asking me, do I think it could be an effective tax proposal, because I think that is the right question——

The CHAIRMAN. It is not what the media asks.

Secretary RUBIN. Well, the media does a lot of things, Mr. Chairman, and we have a first amendment. So, life is what it is.

But I think the real question is, how do we best deal with the issue of making sure there are job opportunities for those moving off welfare? In our view, this proposal has a real potential for working with private sector employers.

The CHAIRMAN. Well, my concern is that you can argue, if you look at it from the employee point of view, that it has great merit. On the other hand, if you look at the employer, you can say, well, it is a major tax break for them.

Let me turn now to other matters. Over the weekend, the President's Chairman of the National Economic Council, Gene Spurling, commented on the issue of the accuracy of the consumer price index and the administration's current thinking on this subject.

He said, "What we are going to do is look for where there is broad-based technical agreement. If that broad-based technical agreement means that the cost of living adjustment needs to come down a little and it is technical, and it is real, and it is scientific, then we will support it." He also added that, "We are going to try to take the politics out of this and do the right thing."

Clearly, Mr. Secretary, I think this is a very encouraging endorsement of a need for a more accurate measure of inflation. What, in your view, is the President's position on CPI?

Secretary RUBIN. Oh, I think the head of the NEC stated it pretty clearly. I do not think that he would wander too far from the President's view. But let me state it as best I can, Mr. Chairman. The President has said on a number of occasions that Social Security needs to be fully indexed for inflation, number one.

Number two, that the CPI, as the Ranking Minority Member so often pointed out, is a price index, not a cost of living index, that it is almost universally acknowledged by economists across the political and intellectual spectrums as overstating inflation.

Now the question is, can we adjust it in ways that are grounded in not politics, but expertise, so that we will better reflect inflation. That is the challenge that lies before us.

The CHAIRMAN. You undoubtedly know that Dr. Abraham testified before our committee yesterday.

Secretary RUBIN. Yes, I do.

The CHAIRMAN. She admitted that the CPI is an upper bound, as my colleague here has already pointed out, of the measure of inflation. In other words, it can only be lower than its current rate.

Now, in order to achieve improvements in accuracy—and I think that is what we all want—Dr. Greenspan, Dr. Martin Feldstein, and many other economists agree with the Boskin Commission that an expert panel should be established to make recommendations for modifications in measuring the increase in the cost of living.

Would you endorse this idea as an avenue to further achieve accuracy in the measure of inflation?

Secretary RUBIN. We have discussed that, Mr. Chairman. I think it is a little bit premature for me to comment on Chairman Greenspan's suggestion. But I do think what Chairman Greenspan did was very constructive, and I think it is in the spirit of the Boskin report. Somewhere in that report it says something to the effect—I do not remember the exact language—that what is needed now, now that the report has been done, is for people to digest the report and then respond to it.

I think what you see in Chairman Greenspan's response, and other responses have started to come forward, is, I think, a very healthy catalytic process that, in my judgment, at least, was triggered by this Boskin report, and suggests that the Boskin report was, in fact, a very constructive thing to have done.

So I think we have to continue to see suggestions come forward. Then when we see the critical mass of that, I think we can all decide how we react to it and how we handle it.

The CHAIRMAN. Secretary Rubin, in your testimony yesterday before the Ways and Means Committee, and I think it is in your testimony today, you stated that you believe that any tax relief package greater than the $100 billion included in the President's budget would be harmful to our current economy and to our potential economic growth over the next several years.

Now, in light of the fact that our economy is over $7 trillion, the annual Federal budget is over $1.7 trillion, are you really saying that $100 billion tax cut over the next 5 years as an average annual tax cut of $20 billion for middle-income families is all our economy can accommodate?

Secretary RUBIN. Mr. Chairman, I think what the testimony actually said was a tax increase that was much more than the $100 billion, something like that.

The CHAIRMAN. We will underscore the word much.

Secretary RUBIN. What?

The CHAIRMAN. We will underscore the word much.

Secretary RUBIN. Well, I just observe what is there. But I think the problem that you have, is the problem that we had. That is, as you start to increase the tax cut above that, you obviously have to pay for it.

Then you have to reach a judgment. We reached ours, you all will have to reach yours, as to what you think the effects are of the changes you have to make to finance the additional tax cut. In our judgment, at least, this was the size of the tax cut that we felt was appropriate, given everything else we think needs to be done for the country.

The CHAIRMAN. I will just ask one more question, Mr. Secretary. As you know, balancing the Federal budget is, I think, one economic goal that we all can agree upon. The benefits of deficit reduction, of course, includes lower interest rates, lower debt burdens for our children, lower cost of capital to businesses.

Clearly, balancing the budget will bring about what has been called a fiscal dividend that, in my view, should be returned to the American people in the form of tax relief.

What, in your view, is the most productive use of our fiscal dividend that would materialize if the budget is balanced?

Secretary RUBIN. Well, I guess I would look at it a touch differently, if I may, Mr. Chairman. I think that what we did in 1993 was absolutely central to what we have had in the last 4 years. As you may remember, once the markets saw what the President was planning to do in terms of his fiscal policy, you started to see an impact on interest rates and you started to see a significant impact on business confidence.

I think that if we can go to balance we will continue to get substantial additional benefit in both those areas. What we have done, is taken into account the benefits that we think will occur with respect to interest rates, and then we have included the gains thereby in constructing our total budget.

So I guess my answer to your question is, we did not try to separate out a fiscal dividend. What we said, was we expect interest rates to move in the following ways, and that is reflected in our budget document. When you take all of that into account, what we think we can do is we should provide about a $100 billion tax cut and then we should have very strong emphasis on education, on training, on the kinds of programs that we think are absolutely critical if we are going to be productive and competitive in the years ahead.

The President increased—and I will ask Mr. Lew for the numbers, because I do not remember them—total resource allocation very substantially toward education in this budget. Well, I will tell you, in a G–7 meeting, when you talk to people there, what are you doing to get your countries ready for the next century, the overwhelming emphasis was that the nations that have fiscal responsibility and have well-trained work forces are the nations that are going to prevail. How much did we increase, Jack?

Mr. LEW. Well, in 1997, total resources devoted to education were $42 billion. For 1998, we are proposing $51 billion, a 20 percent increase in resources devoted to education on both the spending and the tax side.

The CHAIRMAN. Well, as I said in my opening remarks, this is an area where both sides of the aisle have been proposing increased benefits to promote better training of our young people, and I think we all agree with that. Where I part company, however, is whether or not $20 billion a year is enough in the form of tax relief. I am sure that is something you and I will want to discuss further.

Secretary RUBIN. I suspect that will be a subject of discussion, I agree.

The CHAIRMAN. Thank you, Mr. Secretary.

Secretary RUBIN. Thank you, Mr. Chairman.

The CHAIRMAN. Senator Moynihan?

Senator MOYNIHAN. Mr. Chairman, I suggest that we could make some progress in this matter of getting an accurate cost of living index for our benefit programs and our tax programs. There will be the resources available to make a discussion such as you suggest a useful one. There will be monies available.

We have shown we can do these things that we were uncertain of. I remember in 1993, as the Secretary comments, in that measure which we put through the Finance Committee, we proposed a reduction in outlays at an increase in revenues of $505 billion over a period to 1998. I see Mr. Lew is nodding.

OMB now projects that the cumulative deficit reduction through 1998 will be $924 billion, almost twice. You came here early on and set interest rates. There was $100 billion extra from the drop in interest rates. We got almost twice what we reckoned for, which should cheer us up in terms of taking some risks here, risks which are really only the ones of dealing with people who do not want you to do. I thought your comment about the CPI, the consumer price index is not a cost of living index is very valuable. I think we are very close to something very important here.

Could I just ask one other question. You raised the issue of Medicare and you said the President's budget will keep Part A in balance until the year 2007. Well, that is 10 years and that is not that far away. Then we do have a problem, and it begins to compound as the retirement of the baby boom generation begins.

Would you have any view regarding, I believe the President has indicated he would respond favorably to the idea of a commission to look into this? The Chairman has, I believe, indicated his disposition in this regard.

Secretary RUBIN. Yes, Senator. The President has said on a number of occasions, and I think rightly so, that while we can try to deal with Medicare in the shorter-term sense—and that is what the budget does, it deals with it in the context of the 5-year budget window, what we all know we have looming, and as Senator Kerrey's commission pointed out so well, are these very large, longer-term demographic issues and the entitlement problems that flow therefrom. So what he suggested, and I believe he did a State of the Union address, or correct me, and other places——

Senator MOYNIHAN. Yes, sir. I believe so.

Secretary RUBIN [continuing]. Is that we set up a long-term, bipartisan, Medicare process, most likely a commission, which addresses the long-term issues of protecting the Medicare program, at the same time dealing with the fiscal problems, and that we do the same thing on the Social Security side.

Senator MOYNIHAN. On the Social Security side.

Secretary RUBIN. Yes. He has suggested we do so for both.

Senator MOYNIHAN. Yes.

Secretary RUBIN. Having said that, at the moment our energy is focused on doing everything possible to put in place this balanced budget legislation, although there is nothing inherent in doing that that precludes also beginning any other process. All concerned felt that was appropriate.

Senator MOYNIHAN. Would you further agree, sir, that insofar as Senator Kerrey raised these issues, which are so discomfiting to so many, that a consigned punishment would be for him to serve on such commission? [Laughter.]

Secretary RUBIN. He is shaking his head no, and that is not for me to say. [Laughter.]

Senator MOYNIHAN. Thank you very much, sir.

The CHAIRMAN. If I could, I would just like to make a short comment. Senator Moynihan is correct, in that I have sponsored such a bipartisan commission. I would say, however, if I had my druthers, I think it would be desirable to address the long-term problems promptly, because I think we basically all know what has to be done. But, based on the experience of last year, it does not appear that we are going to reach a consensus.

So maybe the best way of doing so, for that reason, I have proposed a commission to help develop that kind of consensus, not only in the Congress, but with the White House.

The CHAIRMAN. Next, we have Senator Grassley.

Senator GRASSLEY. Mr. Rubin, the first point, is I would respond to an issue you brought up about the necessity for education in our global economy to prepare us to be competitive.

I agree with you 100 percent, and I think Republicans would say they agree with you 100 percent because we ourselves, last year and this year, have dramatic increases in expenditures for education. What I am going to say about the President's budget may also be true of some things where we are orienting directing our expenditures. But 90 percent of the President's increase in expenditures for education is directed towards the college level. There we have a good system of education. Where we are not competing for the world economy, or are not preparing ourselves to compete for the world economy, is K through 12.

If the goal of the President is preparation for us to be competitive, which I think is a major goal that we should have, that the President ought to think of directing more than just 10 percent of new resources towards K through 12, where everybody agrees and everybody has a concern, about our educational system, whereas, there is not that concern for higher education.

There is concern about the cost of higher education and preparing people to go to college, but as far as the system itself, it is not in the disrepair that our K through 12 is.

Secretary RUBIN. Senator, let me respond briefly to that, if I may, because I think your point is well-taken. K through 12 is generally regarded, I believe, as the more serious problem, the piece of our problem that most needs addressing.

As you know, that was subject to address at some length in the State of the Union address, particularly with the question of national standards, where a lot of educational experts think a lot of the answer may lie. As you may remember, he had other suggestions as well.

But he really views it as a two-part problem. One, the K through 12, where the Federal role is much more limited. There, as I say, he addressed national standards and various other programs that he was putting forth.

Then the question of opportunity to get post-secondary school education. It was really an opportunity to get post-secondary school education that the tax credits in our budget are addressing.

Senator GRASSLEY. Still, you have to see the budget as a chief policy instrument of an administration. If the problems K through 12 are only 10 percent of the new resources that are going to K through 12, that sends a signal, regardless of the Federal role in education, that the administration sees less of a problem there because the resources are not going to that.

Secretary RUBIN. No, I do not think so, Senator. I think what it suggests, and I would like Mr. Lew to address this as well, if you take the budget and comments in the State of Union address and you add to it the other occasions on which the President has addressed education since the State of the Union address, I think what you have is a multi-faceted program, and a fair portion of the program that is directed toward K through 12 does not reflect itself in the budget, for example, the emphasis on national standards.

I also think that the opportunity to go to post-secondary school education, some relief for hard-pressed middle-income families that are sending people, is a very important part of our total educational picture.

Let me see if Mr. Lew has a word on that.

Mr. LEW. Senator Grassley, in the elementary and secondary education program there are actually very dramatic, new initiatives. Just to give a brief summary of them, beginning with Head Start, we have increased funding by over 10 percent. That is the first step towards elementary education, to have kids get to school prepared to learn how to read.

The budget includes an initiative, the America Reads program, which over 5 years, is a $2.75 billion initiative to deal with the problem that the President identified so clearly in the State of the

Union, which is that we need to get third and fourth graders to the point where they are reading and reading well.

We have an initiative in educational technology to make sure that the classrooms that our kids learn in all have the tools that they need to participate in the economy in the coming century.

Senator GRASSLEY. Let me interrupt you, because we have heard those. I do not disagree that those are important and good initiatives. I just want to make the point, and you have not disputed that point yet, that only 10 percent of the new resources are going to K through 12, where we have our biggest problem. I want to go on to another point if I could, please.

Secretary RUBIN. Sure.

Senator GRASSLEY. That would be to challenge you, not whether or not the President is well-meaning when he says the era of big government is over, because I believe the President believes that, but whether or not people below him, including present company, are serving him well if they bring to him lots of additional programs that, singly, the President would say, yes, I want to do this, but, collectively, they send a message that maybe the era of big government is not over. Like, for instance, we have six new entitlements in this budget.

I do not believe that you could name a single program, outside of defense, that President Clinton is actually cutting, and that only 7 percent of the reductions in expenditures are going to come between now and the 1998 election. Only 7 percent.

We are going to spend more in 1998, not just more than is being spent now, but more than the increases already written into the budget baseline. Then we even have a net tax hike for 1998. We have $98 billion of tax cuts, but these are offset with $96 billion in tax hikes. Then, in addition, we have $47 billion in new user fees. So we are going to spend more and we are going to have more income coming in from somebody. Maybe you do not call it all taxes, but you still have got more coming in. So is the era of big government really over?

I was fortunate enough, preparing myself for this meeting with you, and was able to observe C-SPAN last night and your exchange with Congressman Archer. I really feel that there is something wrong with, we have got a better economic environment now than we had 12 months ago, still spending what we decided we were going to spend last year and maybe getting to a balanced budget a year sooner than the year 2002, that somehow we in Washington—and maybe this is the fault of Republicans as well equally, we take some blame for this—that we have got to spend every penny we are taking in and we cannot be satisfied with a tax decrease. We are even going to increase revenue so we have got more money to spend. We ought to put it towards the deficit.

Secretary RUBIN. Well, could I respond to that, Mr. Chairman?

The CHAIRMAN. Go ahead.

Secretary RUBIN. If you take a look at that chart there, it will show you what has happened since President Clinton has been in office. We started with outlays—Federal outlays—at roughly 22 percent of the total economy. That is at the beginning of this administration. And, by the time you get to the end of this year we are at 20.8 percent, so we have come down some already, as you can see. By the time you come to the end of the President's budget track, we will be at 19.0 percent.

So we are on the way toward reducing government very substantially as a percentage of GDP. And I might add, I believe it is the lowest percentage of GDP by far amongst our G–7 partners.

Senator GRASSLEY. I do not dispute that, Mr. Secretary, at all. I know my time is up. Just let me say that I do not dispute that at all. There are very healthy trends. But it is always like living on the edge. Every dollar we can squeeze out of enhanced economic growth, we have to spend it, or every dollar we can get out of new user fees, we have to spend it, always living on the edge. What we ought to do is be planning for a recession sometime between now and the year 2002. We are going to have one. Then that blows everything you have got there.

Secretary RUBIN. You have raised a separate set of questions, I think. But I think that the best way to prepare for a recession is to have a healthy economy. What we have tried to do over the last 4 years, and I think have done with really quite considerable success, is to get this country back on a healthy economic track through a combination of fiscal prudence, after 12 years during which our Federal debt quadrupled, and at the same time investing in the areas that are absolutely critical to future productivity.

Could I comment on just a couple of numbers you threw out, because I think they are——

The CHAIRMAN. I would ask that you be brief, because we do have a number of additional questions.

Secretary RUBIN. Let me try in just one sentence. You said that our expenditures are actually above the 1998 baseline. That is not really so. Our expenditures are below the 1998 baseline, but we are starting our tax cut in 1998. That is the reason for the baseline effect. We actually brought our expenses down, and then we use the benefit of that for a tax cut. In terms of no cuts other than defense, well, one obvious cut was Medicare of $100 billion. But there are a whole slew of other non-defense cuts in this budget.

In terms of the 7 percent before 1998, our deficit reduction track is consistent, on a percentage basis as it phases in, with the track that was recommended by former CBO Director Reischaur a couple of weeks ago in the Washington Post, and with the illustrative track the CBO set out, I do not know, two, three, four weeks ago, I have forgotten. I think it is very much consistent with sound budget planning, Mr. Chairman.

The CHAIRMAN. Next, I will call on Senator Bryan. I just want to make, however, one observation. That is that the economy has been doing well for 72 months, or 6 years. I think that should not be overlooked.

Senator Bryan?

Senator BRYAN. Mr. Chairman, in order to promote harmony in the body, I arrived after several of my colleagues here. I just do not want to provoke discontent.

The CHAIRMAN. Our listing is not correct? Impossible.

Senator BRYAN. Senator Kerrey was here before I was, and a couple of others.

The CHAIRMAN. Senator Graham.

Senator GRAHAM. Thank you, Mr. Chairman. Mr. Secretary, thank you very much for your being with us today and your very lucid explanation. I would like to focus on the issue of education.

In the materials that you provided as giving explanation of the President's proposals, under the area of Hope Scholarship tuition tax credit, the statement is made, "The administration believes that reducing the after-tax cost of education for individuals and families through tax credits and deductions will encourage investment in education and training, while lowering tax burdens for middle-income taxpayers."

Do you have some approximation of the numbers of additional students who will be relieved of the economic obstacle which currently prevents them from seeking post-secondary education and training?

Secretary RUBIN. Senator Graham, the answer is, we do not. I do not think there is any question but that very large numbers of hard-pressed middle-class families find it very difficult to give their kids post-secondary school education, but send their kids anyway. Part of the objective of the Hope Scholarship, and of the deductions, for that matter, is to try to relieve some of that pressure.

In addition, I do not think there is any question but that there will be some people who have the opportunity to go who would not otherwise have gone. But we do not think there is a way to quantify that.

A third fact of it that I think is worth noting, is that too large a percentage of those who enter college drop out. So the question is, how much of that is for financial reasons. We do not know the answer to that, but it is our hope that the combination of the credits and the scholarships may help reduce that drop-out rate.

Senator GRAHAM. I would encourage some further analysis of that question for this reason. Approximately 70 to 80 percent of students who attend post-secondary institutions attend State-supported institutions, community colleges, State colleges, State universities.

In my State, which I think is fairly typical, the State bears the full cost of building the classrooms and laboratories, and tuition covers approximately 25 percent of the actual cost of instruction, with the other 75 percent being borne by the general taxpayers of the community or the State.

If there is going to be a substantial increase in the number of students who will be attending schools or students who are currently attending who will be able to extend their education as a result of this, we are, for good and sufficient reasons, but we need to understand the financial burden that we are about to shift to States and communities in order to pick up the cost that those additional students will mean to them.

Has there been any calculation of what that cost will be, and are there any proposals to assist the States in their financial burdens that will be incident to this policy?

Secretary RUBIN. The answer to your question is, there has not been an effort to make those calculations, nor is there a program designed to aid the States. I would say this, Senator. If your view is that the principal impact will be to, as I said a moment ago, enable hard-pressed families that are struggling right now to carry this through, to better enable them to carry through what they are doing anyway and hopefully reduce the drop-out rate as this process goes along, I do not know how much additional cost it will create for the States, but it is a good question. I do not know the answer to that.

What I do know, but I think is generally felt, is that it is absolutely critical that as many people as possible get the opportunity for post-secondary school education if we are going to compete with the other Nations of the world that have exactly the same strategy for competing in the global economy.

Senator GRAHAM. I agree completely with the goal of encouraging more students to be able to complete their education. I think the full implications of doing that in the manner suggested need to be detailed and some thought given to the implications of this to States which are already going to be hit with Federal policies in welfare reform, immigration, and other areas that have substantial costs to the State.

Second, I share some of Senator Grassley's concerns about the balance of this program. I think most Americans feel that their greatest educational challenges are at the elementary and secondary level.

And, while I agree that the Federal Government has a secondary role in elementary and secondary, there is a role that the Federal Government could play to a greater extent than is called for, and that is in the area of physical facilities.

Most educators would say that the key to the teaching/learning process is to have a well-prepared, professional adult interacting with a reasonable number of students. The fact is, in many school districts today that is not a reasonable number because of the inadequacy of classrooms and the financial limitations on hiring a sufficient number of those well-trained professionals.

I would hope that we could look at an expanded Federal role in meeting the capital outlay needs of States and school districts which is an area that is critical to achieving the educational objective, yet does not involve the Federal Government intrusion into curriculum, personnel, and other policies that raise the question of inappropriate Federal involvement in education.

Secretary RUBIN. Just in a one word answer, if I may, Mr. Chairman. I agree with your general comment, and the GAO, I know, has done a study that is very supportive of your comments. We have in the budget a school construction program designed to achieve exactly the purposes that you have suggested.

Senator GRAHAM. I agree with that. I am a co-sponsor, and my good friend and colleague, Senator Moseley-Braun, is the principal sponsor. I think that is a good step. But my concern, is that the GAO study says just to meet the needs of old buildings that need rehabilitation, we have a national unmet need of in the range of $120 billion.

The estimate is that, to meet the needs of new construction or growth areas, it is probably an equal amount. This program calls for $5 billion over four years. I would question whether that is a sufficient Federal commitment to a problem of the scale——

Secretary RUBIN. The $5 billion is, of course, an interest subsidy. Our hope is that would generate about $20 billion or so additional activity.

The CHAIRMAN. Senator Kerrey.

Senator KERREY. Thank you, Mr. Chairman. The only advantage of sitting down here, is I can ask that the charts be put back up.

Mr. Secretary, one of the things that, of course, has to occur in this whole process, is eventually we have got to go to the floor and vote on something. Very often in politics we have a tendency to take the best and make it the enemy of the good. It seems to me that we missed an opportunity last year.

I mean, it seems to me that that may have happened last year. I mean, one of the things that you have not shown, and I would appreciate if you could in a follow-on, tell me what would have happened if the President's budget had been accepted last year.

Last year there was a critical time when he offered to the leadership to accept many of their assumptions, but we lost that opportunity and did not take action. There was no OBRA 1996. There was an OBRA 1993. There was no Omnibus Budget Reconciliation Act of 1996 because we made the best the enemy of the good.

So I wonder if, in follow-on—and you do not need to do it now—but do you accept the general presumption that we missed an opportunity in 1996 and that we ought to be careful in 1997 that we do not do the same?

Secretary RUBIN. Senator, I think we had a great opportunity last year. I think if we had so taken advantage of that opportunity we would have had an ever better track than the track that we outline in the budget we presented this year. As you correctly say, the opportunity we missed last year, in my judgment at least, we must not miss again this year.

Senator KERREY. There would be less unfinished business today than there is, had we had an OBRA 1996.

Secretary RUBIN. That is absolutely correct.

Senator KERREY. A second thing. I remember very well the 1993 Budget Reconciliation Act. Many have been accused of casting the last vote, but I was the last vote. That was a Democratic Senate and we paid a big price in November of 1994, when the Senate became Republican again.

I am sure both Republicans and Democrats remember that, very often when you do the right thing, you are not necessarily greeted with a round of applause. I found the only complaint when I went home was that we cut spending and raised taxes. Other than that, they loved deficit reduction. It was very popular back at home, other than it cut spending and raised taxes.

But it did produce a long-term impact. The long-term impact is not what we feel, we feel the short-term impact at the ballot. The whole Medicare debate last year has produced some nervousness on the part of the Republican Majority today, at least expressed nervousness, about dealing with that issue again.

My hope is that you will follow the leadership of the Chairman and the Ranking Member of this committee on the issue of changing the CPI and coming up with a COLA. It seems to me we need a 90-day, and a 90-year solution.

They have held repeated hearings on this and there is no question that you have to take the demagoguery out of it, the arguments, both left and right, that are apt to be slung at this thing. There were Senate races this year where people who supported this centrist budget proposal were accused of a big tax increase and being liberal. So the attack will come both left and right on this, and I hope you will follow the leadership that the Chairman and the Ranking Member have shown on this thing.

Just follow it and keep yielding to their advice, because I think there is a bipartisan solution here which will have a $1 trillion, 12-year impact, a big, long-term impact. But the short-term political impact, very much like OBRA 1993, is apt to discourage people from even considering it. So will you follow the leadership of these two individuals down here in the center?

Secretary RUBIN. I guess the best answer I can give you, Senator, is the same one I gave before to, I think it was Senator Moynihan, but maybe it was the Chairman; I do not remember. I will not repeat the answer, but it was to set forth the President's position on this. Basically, I think the question now is to let this process work itself through and watch as expert opinion comes forth around the country.

Senator KERREY. I hope you will recognize that the Entitlement Commission is actually a Presidential commission, put together by the President. Again, one of the reasons that I think that it had credibility was that it was bipartisan. But none of the choices are easy. There is no easy choice here.

I applaud both the 1993 proposal and your proposal, I think it is precedent-setting and I hope it establishes a precedent for the future that all future Presidents will come to the Congress with a balanced budget. Still, one of the things that troubles me about it, is I think it is going to be a relatively easy vote.

I do not find anything in here that I am going to have to really worry about when I go home. The Medicare changes can be tough. Some of the Medicaid changes can be tough. It is not as difficult as OBRA 1993 was. I think one of the tests that we, as politicians, need to put on whether or not it is going to produce some long-term impact is, is it a tough one, is it a difficult vote?

There is no question, if we move from a CPI to an accurate COLA, if we look at some changes on Medicare and some other things that would produce big, long-term savings, no question that would toughen the vote and make it more likely that you are going to be able to come back in 4 years from now and say, I am going back to the private sector now, look at what OBRA 1997 did for our future.

Secretary RUBIN. Well, we did take a lot of hard choices in 1993, and you are correct in that regard, Senator. But there are enough hard choices here, as your constituents look at it and get familiar with it, so I think you will have opportunity for discussion.

Senator KERREY. I think there will be opportunities for discussion, but I think you will acknowledge, and I am not saying it is a bad budget at all. I think you have made a good faith effort, and I applaud the administration for setting a precedent, I hope, for the future.

So I am just saying that, as we look at it, rather than making it easier, we ought to consider making it tougher because it was the very toughness of the 1993 proposal that produced the benefit.

Secretary RUBIN. No, I think your point is well taken in this regard, that 1993 was a very tough budget and it took us a long way. We did it at a time when we were in a fiscal mess. But this is a strong budget, Senator.

Senator KERREY. My bell has gone off. Just a two-sentence fact. One additional thing that the Entitlement Commission noted, and I know that you understand it but I want to make it for the record and I hope that you will begin to describe it, is that the growth of mandatory and interest spending inside the overall budget continues to grow.

It will be 70 percent at the end of the President's term, at the end of this budget plan. It will be 100 percent in 2012, 2013. We still have a growth of spending in mandatory and interest, and that is what set off the debate earlier between the Chairman and the Ranking Member.

They were saying that we could have a debate about, should we put it in discretionary spending or should we put it for tax relief. Right now, we are heading in a direction where the only question is which transfer program do you want to spend it on.

Secretary RUBIN. Well, we clearly have a growth of mandatories relative to the rest of the budget, which is unhealthy. On the other hand, if this budget is put in place, there is a chart in there someplace which will show you that, on HCFA assumptions with respect to Medicare, HCFA assumptions with respect to Social Security, we will be in balance until 2020.

Now, the big problems that you point out in the Entitlement Commission are there, they hit us afterwards, and they must be dealt with.

Senator KERREY. No, even in the short-term. We go to 70 percent mandatory spending in interest. We are at 66 percent now. We are going to grow another full four points. In four points' time, $1.7 trillion is real money.

Secretary RUBIN. Senator, Jack Lew just suggested to me, which I was going to say anyway, is that you are right on a baseline basis, but if you take into account the budget that we are proposing and you look at that chart, I think that you will see we are actually in relatively good position through 2020. It does not in any way take away from the importance of addressing these issues in the long term.

Senator KERREY. Back in regular order.

The CHAIRMAN. Regular order.

Just one observation. Many of us on the Republican side thought there was a missed opportunity when the balanced budget was vetoed. But there is no point in going back to last year.

Next, we have Senator Bryan.

Senator BRYAN. Thank you, very much, Mr. Chairman.

Mr. Secretary, I think you, the President, and the administration can take a great deal of credit for having reduced the annual deficit over each of the last four years. I, for one, appreciate your continued public service on behalf of the Nation. I want to say that publicly.

Let me ask you a question about Social Security. This budget, as well as other budgets submitted by both Republican and Democratic administrations, continues to include Social Security surpluses as part of the budget. Does this concern you, as Secretary?

Secretary RUBIN. I believe that in the current context of a unified budget, it is a question that reasonable people can very usefully debate. I think, in the current context, a unified budget, which is what you are referring to, makes sense.

What you have, at least in my view, is you have receipts and you have outlays. You also have a real trust fund, you have real assets, you have real obligations, you have real legal protections, and you have a real board of trustees, which I happen to be the chairman of.

So I think that you have a system that both makes sense in a budgetary sense, at the same time provides protection to Social Security. It is also my belief—not my belief, I think it is an analytic fact—that if you went into a balanced budget amendment context in the form that is now proposed, that the protections currently obtained in the legislative process for Social Security would not obtain if there impasse and the Social Security and other budgetary issues, in effect, had to be resolved either in a court, or unilaterally by a President.

Therefore, there would be additional risks for Social Security, which is why I have said on other occasions that it seems to me, in a balanced budget amendment context, you have a rather different situation. You have new risks that do not currently exist for Social Security.

That, it seems to me, you can only address if you have a balanced budget amendment that excludes Social Security. That involves a lot of other problems, and it still involves the fundamental problems of a balanced budget amendment, but at least it does eliminate this additional risk to Social Security.

Senator BRYAN. Well, as you say, reasonable people can disagree about many aspects of the budget process, and certainly the balanced budget amendment is one on which reasonable people can disagree.

But, putting aside the balanced budget amendment, I mean, to continue to use the surpluses that have been generated, does that not compound our problem in terms of long-term solutions when that day occurs, whether it is 2029 or whatever the date is, when, indeed, the fund is going to have real difficulty remaining solvent at that point.

Secretary RUBIN. Well, look. I think it may be, Senator, that the day will come, so I am basically, in a sense, agreeing with part of your point. Right now, we have an enormous challenge. We started out with a $290 billion deficit 4 years ago, we have gotten down to $107 billion. We have a track that will take us to balance in 2002.

I think what we have done already is an enormous accomplish. I think we can get to balance in 2002. That is an enormous accomplishment. But I can see where the day might come where the Nation might decide that it, in fact, does want to separate out Social Security.

Once again, if you put in place the balanced budget amendment in the current form, you then have precluded yourself from making that policy change. It is that kind of inflexibility that is involved in the balanced budget amendment which, it seems to me, is one of the reasons why it is such a desirable policy for this Nation.

Senator BRYAN. Let me get your reaction. As you know, the Social Security Advisory Commission has come up with three different options for us to consider, without asking you to endorse any one of those provisions, but a general question.

From your point of view, would it be desirable, would it be helpful, would it be good public policy, for us to consider investing some of that money in the securities market beyond what is currently authorized by law?

Secretary RUBIN. In equities, you mean?

Senator BRYAN. Yes, in equities.

Secretary RUBIN. Well, the market has gone up, I think, seven times since 1982. It is not surprising to me that there are people who think that investing in equities is an attractive idea. I am not saying it is or it is not. As Secretary of the Treasury, I never comment on levels of market or express any views on markets, and I am not so doing right now.

Senator BRYAN. Nor do I ask you to do that, Mr. Secretary.

Secretary RUBIN. But I do think this. I think that before that decision is made, there are very serious issues about risk and volatility that would have to be very, very carefully weighed and evaluated. I think that those kinds of issues tend not to be enough part of the dialogue in an environment in which the equity markets have done so well.

Senator BRYAN. In your former life, you had a considerable experience on Wall Street. Are there concerns for us, in terms of public policy, that if we do decide to permit that or to authorize that, who makes the decision as to what equities we invest in, and if the government makes that decision, what is the potential impact on the market? Not in terms of whether it goes up or down, but the policy implications.

Secretary RUBIN. I think, Senator, you are raising extremely important questions that would have to be thought through with great care, and I do not have ready answers for you. But I will agree with you that, aside from the questions I raised, the volatility and risk that one would have to look at with great care, what impacts volatility and risk could have under circumstances that no one can yet foresee, I think there are also what I would call sort of process kinds of questions that you are raising that are extremely important. I do not have ready answers for you, but I think they are very, very important questions.

Senator BRYAN. My time is up. Let me yield back the balance of my time. I thank the Chair.

The CHAIRMAN. Senator Moseley-Braun.

Senator MOSELEY-BRAUN. Thank you very much, Mr. Chairman. Thank you very much, Mr. Secretary. I want to join my colleagues in congratulating you on this budget and the work that you have done here. I, at the outset, want to associate myself with the remarks of Senator Graham.

I am very, very interested in seeing to it that we can do something about rebuilding our crumbling schools in this country, that we can make the kind of investment necessary. It will be good for States and local governments, for taxpayers who pay property taxes, as well as for the contractors and the people who rebuild some of these buildings, as well as our kids. If we are going to win this international competition, we have to make certain that our young people are given the tools with which to compete in a global economy.

Secretary RUBIN. I agree.

Senator MOSELEY-BRAUN. Certainly you cannot have a computer if you cannot plug it up because there is no wiring. So we have to, I think, focus in on these infrastructure issues.

I wanted to ask you about this budget, however, the specifics particularly as it pertains to children. There is a provision that allows for families with small children to receive a tax credit for children under the age of 13. I think that is wonderful, on the one hand, particularly in modern families where you have both parents working outside of the home. The expenses associated with day care, and child care, and education and the like really has the effect of being a huge, huge burden for young families. So this is, I think, an important step forward.

But I have a couple of concerns that I would like to raise. One, is that while we, on the one hand, provide this tax credit for families with small children, the credit is not refundable. So that means that if the taxpayer, the two people working, do not have a tax liability amounting to the same amount as the credit, then it really does not have the value to them that it could.

If, indeed, we are serious about family values, it seems to me that, at a minimum, we should be able to make this a refundable tax credit so that those families in the middle—and recognizing the Earned Income Tax Credit figures into this—it still would be a greater assist to families that have their children in day care, child care, or are paying for school if it were a refundable credit.

I looked to see if we could find a number in terms of what the difference was, occasion the revenue difference, in terms of the refundability factor and have not, through all of this paperwork, been able to find that number.

So my first question is, had you considered refundability, is that something we can talk about? Again, because it will help moderate income families more to have it refundable. If you considered it, do you have any idea of what the number is, the revenue difference occasioned by the refundability feature?

Secretary RUBIN. We originally had constructed this, for the reasons you have said, as a refundable tax credit. Then the decision was made, and I could ask Mr. Lew to expand on this if you would like, to make the credit itself non-refundable, but to take the same resources and to accomplish exactly the same purpose by increasing our PEL grants, because we thought that was a more effective way of accomplishing the same purpose.

Senator MOSELEY-BRAUN. But PEL grants are for college kids. These are not the families with little ones going to day care every day.

Secretary RUBIN. I am sorry. I thought you were on the Hope Scholarship.

Senator MOSELEY-BRAUN. No, sir.

Secretary RUBIN. I apologize.

Senator MOSELEY-BRAUN. I am on the tax credit for families.

Secretary RUBIN. Oh, the child tax credit. Oh, I apologize.

Senator MOSELEY-BRAUN. Yes.

Secretary RUBIN. I am sorry. On the child tax credit.

Senator MOSELEY-BRAUN. Child tax credit.

Secretary RUBIN. I apologize. My mind was on the Hope Scholarship.

Senator MOSELEY-BRAUN. It is $300 per child through 2000, then it is $500.

Secretary RUBIN. No, no. I know the credit very well.

Senator MOSELEY-BRAUN. All right. Sorry.

Secretary RUBIN. I started off on a different track than you were.

Senator MOSELEY-BRAUN. Well, I started talking about schools, too, so maybe it was my fault.

Secretary RUBIN. We can come back together again on the child credit. Well, the judgment we made was that we really accomplished the purpose that you were directing yourself to in 1993 when we expanded the EITC, and very substantially, I might add. The object here was to try to do something for middle-income families. I do not know offhand what the costs would be to make this refundable. We could get that for you.

Senator MOSELEY-BRAUN. I would appreciate that. I looked for it, and could not find it. I just think that, again, I know all too many families where both of them are working outside the home, they make about $30,000 a year. The child care expenses, you would be stunned at what day care costs. And particularly with payroll taxes being as high as they are, those middle-income families are really struggling. I think making this tax credit for small children refundable will be a great help to them.

Secretary RUBIN. But, as you well know, what we did was to try to take scarce resources and apply them in what we thought was the most effective fashion.

Senator MOSELEY-BRAUN. Yes, I do understand, as always. Right.

Secretary RUBIN. We will get back to you on that.

Senator MOSELEY-BRAUN. The other question I have, is that the child tax credit for families with children under 13 sunsets in the year 2000, so just the year that you take it to $500 per child, it sunsets. I do not understand why that is so. At least according to Joint Tax, it sunsets. Now, you tell me.

I do not understand why that is so. It does not seem to me that, again, if we are making a statement about a policy statement, particularly about family values, why would this be one of the taxes to just kind of disappear in the year 2000?

Secretary RUBIN. Well, in our judgment, at least, these taxes would be ongoing in the budget.

Senator MOSELEY-BRAUN. Well, we have a problem then, because Joint Tax says, or the OMB document states, the specified tax will sunset at the end of the calendar year 2000.

Secretary RUBIN. Senator, maybe I can help clarify this for you.

Senator MOSELEY-BRAUN. All right.

Secretary RUBIN. What we have done, is we have created a budget based on what we think are prudent and realistic numbers, very much what we did in 1993 and have done through the 4 years that we have been here. In every year that we have done this, the deficit has come in under our numbers, so I think at this point we are very well-grounded in saying we have really made conservative assumptions.

If circumstances turn out to be in accord with the assumptions that our budget is based on, then these tax credits will continue intact, as proposed.

Senator MOSELEY-BRAUN. Right.

Secretary RUBIN. What we have are reconciling mechanisms, if circumstances turn out to be less attractive. Or I should not say less attractive, but less favorable than the conservative assumptions we have made. In that event, under some circumstances these tax cuts could trigger off. We do not expect that to happen.

Senator MOSELEY-BRAUN. If I may, just one last question to follow-up. I guess I have less of a problem with the fact that you have got an adjusting mechanism. I guess my concern here, is that it is the provisions that relate to individual taxpayers, like this one, that sunsets.

Some of the other mega-tax cuts that apply to businesses and the like do not sunset under the same mechanism. It seems to me it is a dollar in, dollar out. I mean, if the target goals are not reached you could just as easily sunset one of these esoteric business tax credits as the one pertaining to small children.

Secretary RUBIN. Well, my recollection is that virtually all of the tax cuts that have any real magnitude in them, in terms of real money, Senator, that we have in this budget will sunset, if, in fact, the assumptions are not satisfied. Our judgment is that they will be.

Senator MOSELEY-BRAUN. Thank you very much, Mr. Secretary. Thank you, Mr. Chairman.

Senator MURKOWSKI. Mr. Chairman?

The CHAIRMAN. Yes.

Senator MURKOWSKI. I am going to have to leave. I would like to submit written questions for the record.

The CHAIRMAN. The record will be kept open until 5:00 for written questions.

Senator MURKOWSKI. Thank you very much. I wanted to compliment the Secretary on his effort on Mexico. I was a great critic of that, and he was successful. I commend him for that.

Senator MOYNIHAN. Mr. Chairman.

Secretary RUBIN. Well, let me say, Senator, if I may, you were a helpful critic, though, because you kept us focused on the importance of the security—no, I am serious—of the oil, we could not use the word collateral, but, in effect, it was collateral. The result was, we strengthened the provisions beyond what they might have otherwise might have been.

Senator MOYNIHAN. Mr. Chairman, can I say that I am sure, on our side, we would want Senator Murkowski to ask the questions that he has, if he has the moment to do so.

Senator MURKOWSKI. Well, I appreciate that very much. I will be very brief. I have got an appointment at 11:30. I am just very sensitive to the taxing of kerosene, as we went through the taxing with diesel, because in my particular State kerosene is used for jet fuel.

And that is not an issue, but heating fuel is. If we are required to go into a dual dying situation, we will die on the vine. I would assume that you would be sensitive to what you allowed previously as an exemption for our State from diesel dying, you would consider the same for kerosene.

Secretary RUBIN. Let me say that I remember your having raised the issue with respect to diesel dying, not an issue I view myself as a great expert on. But we would be happy to get back to you on it.

Senator MURKOWSKI. And the other issue I want to bring to your attention, too, is the depletion on hard-rock minerals. I do not think it is the intention of the administration to drive the domestic mining industry off-shore, but a combination of percentage depletion on hard-rock minerals, which is in your budget, and the administration's intent to mandate, on gross smelter return, is the terminology, as opposed to net smelter return on royalties, there is a lack of understanding in the administration relative to the value of a cup of oil that comes from the ground, a piece of coal that comes from the ground, or a unit of gas, as opposed to a hard-rock mineral that is out there, but, until it is refined, it has absolutely no value other than a door stop.

So I very much appreciate the administration looking at the overall impact that taking away the depletion allowance, plus the royalty issue on hard-rock minerals would have on the domestic mining industry would simply move it off-shore. Thank you very much.

Secretary RUBIN. (a) we will look at it, and (b) we will respond to you on it.

Senator MURKOWSKI. Thank you. I appreciate the accommodation.

Secretary RUBIN. Thank you for your comments on Mexico.

The CHAIRMAN. Thank you.

Senator Rockefeller.

Senator ROCKEFELLER. Thank you, Mr. Chairman.

Just a comment on comments made earlier by Senator Kerrey, Mr. Secretary. Actually, I think the 1993 budget was not substantively difficult in the work that we had to do. We had to reduce Medicare by, I think, $59 billion, and that was done. There were a variety of things. The EITC was in there, the gas tax, a lot was in there. But it was not very difficult stuff.

I think now we are facing very difficult stuff. What made it difficult then, was the fact that the Democrats, who had to do it all by themselves. That is what made a much more ticklish situation. But, substantively, we are at a much more difficult point, I think, unlike what Senator Kerrey was saying.

One of the things that always intrigued me earlier on the Finance Committee was the way we come to the end of a year and we would have to do our part in deficit reduction and we really would not be quite sure.

There was no really systematic way of doing it. So we would sort of attack Medicare, not necessarily beneficiaries sometimes, but usually it was, as I remember, the anesthesiologists and the ophthalmologists. It became to be sort of a joke. We always ended up reducing the payment to anesthesiologists and ophthalmologists.

Then another year before that, 1989, as I recall, we decided, well, we will try something called a resource-based relative value scale as a different way of reimbursing physicians in all of this.

But my point was, it was not particularly attractive and it was caused by the fact that we came willy-nilly to the end of a process when we had the balanced budget, from our perspective—Finance Committee perspective—when we could not do it, and so we would look to Medicare.

Now we have this thing called a balanced budget amendment which, according to one of the papers this morning, may be losing steam in both chambers, and I hope that is the case.

But, in the event that it is not, it will be, I think, very problematic for Medicare if we do go into a situation where, let us say—Senator Moynihan has heard me talk about this many times—back in the early 1980's in West Virginia we had unemployment that ran up to 21 percent, and devastation to the extent that we were laying off tens of thousands of workers. And this was not common just to West Virginia, it was true in the industrial heartland, as we were making a major economic shift that was painful.

Now, if that were to happen again, and I see no reason why it will not; Japan is now going through exactly that same kind of a difficulty, one that we would not have guessed that they would have gone through 10 years after we did, but they are. They are very down about it. They are going to be fine in the long-term.

But if we were to run into that situation again in this country and we had a balanced budget amendment and we had to balance by the end of the year and we had to do our part here in Finance, would we not run into what we used to call sequestration?

Secretary RUBIN. I think that you could easily run into a situation, Senator. I think this is only one of the many problems that a balanced budget amendment creates, and that is, I do think it creates an additional threat to Medicare, if that is what you are saying. If you get to the end of a year and there is a very large, unexpected shortfall, which happens from time to time, then I think the President could be in a position where he would be forced to simply cease sending out all checks.

In fact, some of the proponents of the balanced budget amendment have actually said that if you get right up to the end of a year and there is a large, unexpected shortfall—these are proponents who said this—then what the President should do is simply cease sending out all checks.

Well, if you cease sending out all checks you will cease sending out Social Security checks, you will cease sending out Medicare checks, and you will cease sending out all kinds of other checks, I think, instead of being able to deal with it in some sort of a reasonable and sensible fashion.

Senator ROCKEFELLER. And that, therefore, leads to my concluding point, which is, I do not think any of us are saying that we do not think that Medicare should not contribute to the deficit reduction problem and should do its reasonable part. I do not think there would be any doubt about that on this side, or on the other side.

I think there would be very substantial doubt of the fear of coming to the situation that you describe, where the President would have to take drastic action. I mean, you have to start with the philosophical understanding that Medicare, as broad as it is, only covers about 55 percent of the health care costs incurred by people that use it.

That is why they have to go to Medigap, that is why they have to go to all kinds of other things where they are often victimized by having duplicating policies. And they are spending 21 percent of their income on health care as it is, that being above Medicare.

So it is a difficult problem. Medicare will do its part, but Medicare cannot kind of solve the problem. To be quite certain about that, I am going to be introducing an amendment on the floor, probably after the recess, that will deal with Medicare and its role in any potential situation of that sort, because I regard this as a very dangerous potential move on the part of the Congress, and that is the balanced budget amendment.

The CHAIRMAN. Senator Breaux.

Senator BREAUX. Thank you, Mr. Chairman. Thank you, Mr. Secretary, for being with us, and for so long a period.

I think that it is always important for us to keep all of these things in perspective of what we do in this country, and I think that if anyone has been watching the international scene and the recent G–7 meeting in Berlin, the economic meeting in Switzerland, the U.S. economy is really the envy of all the rest of the world, and not too long ago, it was not.

I think you ought to be particularly commended for what you have been able to do to help turn this around, with Congress, the administration, and all of us. But, I mean, we can all be, I think, very, very proud of how the United States is looked at today economically throughout the world in comparison to what it was just a relatively few years ago.

Let me ask this question. Suppose 3 months from now you are sitting in your office and the red light goes off, and it is the President calling you directly. And he says, Mr. Secretary, please come down here right away. And you rush across the street over to the White House and the President asks you to come up into his private quarters, and it is just you and he sitting there. He says, Bob—I guess he calls you Bob—Congress has just sent me this budget.

Secretary RUBIN. That is the high end of the range, Senator.

Senator BREAUX. High end of the range. [Laughter.]

Senator BREAUX. Bob, blank, blank, blank, blank, Congress has just sent me this budget. Capital gains tax cuts are a little higher than we submitted, and some of the other things are a little bit different, but otherwise, I mean, I think this budget is pretty good.

The only thing I have in it that I need your advice on is that Congress, in a bipartisan fashion, also has in this budget a 1 percent CPI adjustment, based on the Boskin Commission, and I would like to know, Mr. Secretary, what do you recommend I do with this budget. What would your response be?

Secretary RUBIN. I think that my response, Senator, would be a function of the circumstances. Or to put the same thing differently, as I said a moment ago, I do not think there is any question but that the principles are clear: A) you need to protect Social Security fully against inflation, and B) that the CPI, as Senator Moynihan and others have pointed out for so long, overstates the rate of inflation. It is not intended to be an inflation, it is intended to be a price index, not a cost of living index.

The President has said that he thinks any judgment made in this area needs to be based on expert testimony. So I think my advice to the President would depend on the expert testimony, or expert advise, expert opinions, that have been expressed since the Boskin report was issued, and I think probably in large part we have not been catalyzed by the Boskin report.

I think it is very hard to know what opinion I would express to him until we see what is forthcoming in response to that, what I think, is a somewhat catalytic event.

Senator BREAUX. If you said that, what do you think he would say?

Secretary RUBIN. Well, but at that time, you see, we would have a surrounding context of judgment and opinion and I might be somewhat more concrete in my response to him, based on what has been said.

Senator BREAUX. I think he is open to the idea. I thank you. I know it is hard to say now. But, I mean, I think that there is a possibility down the road of both Republicans and Democrats biting the bullet and saying, we are using economic statistics that are wrong and that affects one-third of the budget. And if we do not have enough political courage to not use something that is wrong in determining how we spend one-third of the money, I mean, we really should not hardly even be here.

Secretary RUBIN. Senator, I think there is close to universal agreement—not universal agreement, but close to universal agreement—that the CPI, as currently constructed, is wrong, that it does not properly measure inflation.

I think the real question is, can we find an expert opinion, a basis for an adjustment, that is expertly grounded rather than politically grounded? I think that will really be the question that I would face, if the President were to ask me what my opinion would be, which I presume he will ask, as he will ask the opinions of others when the time comes.

Senator BREAUX. All right.

On another subject, the largest loophole-closing, revenue-raising in the budget is the export source rule.

Secretary RUBIN. Yes.

Senator BREAUX. $7.5 billion of additional revenues. The justification that I read in the book, I guess, from Treasury, is that the reason you are recommending the elimination of this 70-year-old rule that affects U.S. companies exporting abroad is that it means that U.S. multi-national exporters have a competitive advantage over U.S. exporters that conduct all their business activities in the United States.

Now, my question is, I do not understand the rationale for that. Now, I have got a lot of companies in Louisiana that manufacture in Louisiana, pay good salaries in Louisiana, as does every member of this committee, and export to higher tax countries. This rule allows them to equalize it.

The question I have, is I do not see why there is an advantage over other multi-national companies that do not do substantial business overseas. Those companies are not paying any foreign income tax, so how can we say that we have created an advantage if, in fact, the other companies they are competing with are paying no tax whatsoever? We are just trying to encourage exports, and all of our trade laws are aimed at doing that. I think this is just a sledgehammer to the head of a lot of companies that do exports.

Secretary RUBIN. Senator, let me just, in a word, if I may, try to respond to that.

Senator BREAUX. Sure.

Secretary RUBIN. But it is a complicated subject. This rule was set up 70 years ago, as you correctly say, when there were no tax treaties. Its purpose at that time was to try to avoid double taxation, which a lot of exporters are subject to. With the 100 and some-odd tax treaties that we have, I think 130 some-odd tax treaties that we have today, you no longer have the situation that gave rise to this provision in the first place.

Senator BREAUX. All right. Well, what would you think about us limiting it to just those countries that we do not have tax treaties with?

Secretary RUBIN. That is a subject that we could discuss. I do not have an opinion, but it is a subject we could discuss.

Senator BREAUX. Well, just one quick point. If the problem is not there with the 50 countries or so with which we have tax treaties, let us not have this rule apply. But, for all of these countries that we do not have tax treaties where we are being penalized by paying higher foreign taxes, we should continue the rule.

Secretary RUBIN. I think the real issue is, that something that has been created for one purpose has evolved into what, in effect, is a tax incentive. What we are trying to do is put this into a tax-neutral situation where the exporters can take full advantage or get full access to the Tax Code, but do not have an additional tax incentive.

If we are going to have a tax incentive for exports, we believe that there probably are considerably more efficient ways of using those resources. But you have thrown out one suggestion, Senator. I do not have an off-the-cuff response, but it is something we certainly can talk about.

Senator BREAUX. Thank you, Mr. Chairman.

The CHAIRMAN. Mr. Secretary, I have two or three more questions I would like to ask you. But I would like to make the observation, as a follow-up to Senator Breaux, is there does seem to be very broad support for the Boskin Commission amongst economists. Not 100 percent, admittedly, but it is unusual to have so many.

Senator MOYNIHAN. Pretty close.

The CHAIRMAN. Almost 100 percent. I just think it is so important that we not only have bipartisan support for this, but that there does have to be leadership from the White House as well. This is a critical opportunity. I think it is a critical opportunity for the President to make one of those hard decisions he talked about in his very eloquent address, the State of the Union. So I just hope that we can expect some strong leadership from your quarters, as well as the White House, on what I think is as important a question as we have before us.

I do not know if you want to make any comment or not.

Secretary RUBIN. I do not think there is really anything I can add to the comments I have made, Mr. Chairman, other than I think that your comments are well-taken.

The CHAIRMAN. I would like to turn for just a moment to the IRS. As you know, we have talked about looking into the practices of the IRS. There seems to be a feeling among many of our constituents that this is an overbearing, enormous bureaucracy that has serious institutional management problems. I know you are looking for a new commission. I wonder if you would care to comment on what needs to be done in correcting the situation.

The IRS is a servant of the people and it appears that that is no longer recognized. It is a difficult job, I know, and nobody likes the tax collector. You like the postman because he is bringing you a letter from your son or daughter. But, nevertheless, they are the servant of the public.

Secretary RUBIN. You have raised, I think, a profoundly important question and it is one that I expect to spend a fair bit of time on. It is not something that Secretaries of the Treasury ordinarily do spend much time on, but I intend to. Moreover, our Deputy Secretary, as you know, is an outstandingly talented individual and has been spending a lot of time, and will continue to do so, in the 4 years ahead.

It is a very complicated situation. On the one hand, the IRS performs an absolutely essential function.

The CHAIRMAN. And they have a lot of good people.

Secretary RUBIN. They really do. It sometimes pains me a little bit, Mr. Chairman, as I see people attack the IRS. And you are not doing that, you are raising, rightly, a very important question. But there are people who attack the IRS in ways that are not very attractive.

It does have a lot of dedicated people. The consequence is, year after year we have had effective filing seasons and it is absolutely essential to the welfare of our Nation that we continue to have it.

On the other hand, there are real managerial issues and we do need to deal with them. There was a piece in the New York Times, I think it may have been Monday of this week, though I am not sure, which talks about how these problems go back decades.

This is particularly in the systems area, but the systems' problems are very central to the overall problems of the IRS. Problems that have gone back decades are going to take quite some time to repair. They are not going to get repaired overnight.

We are absolutely committed to doing so with a proactive and really a very energetic oversight function that we have now institutionalized at Treasury, and I believe that, over time, we will get this thing back on the right track.

We are now reviewing at Treasury all the major strategic and procurement decisions in the systems area. We have canceled a lot of contracts. We have increased out-sourcing in the systems area from roughly 40 percent to 60 percent.

We were very fortunate, and sometimes it is better to be lucky than to be smart, about 8 months ago—or maybe it was a year ago, I do not remember—to get a new Chief Information Officer for the IRS who is, I think, really outstanding. A very hard job to fill.

We are now seeking a new commissioner who can provide real managerial leadership. We have a multi-faceted program to try to put this on the right track. I think the key, Mr. Chairman, is I think that if we are going to get where we need to go I think we all need to work together. There are real issues, but there are real accomplishments as well. But I think we need to do it in a constructive spirit. I think if we do that, I think we can get where we need to go.

One of the things that troubles me a little bit is that sometimes people, instead of approaching this as you just have with a correct question and a very constructive spirit, approach it in quite different ways that I think are very harmful to the people there, to morale, to getting their job done, and to doing what we need to do to get back on the right track.

The CHAIRMAN. Well, I assure you that what this committee does will be done in a responsible, professional manner.

Secretary RUBIN. I have no doubt about that, Mr. Chairman.

The CHAIRMAN. We think it is a serious problem. I agree with you that part of it is culture, so it is not going to be easy to eradicate, but I think it must be done.

Secretary RUBIN. As we work our way through this, it has really been our view that we are going to need the help of Congress in a number of respects. I think you will find us, Mr. Chairman, asking for some of your time as we go down, in the course of this year, to discuss with you the kinds of things that we are talking about and to enlist your assistance.

The CHAIRMAN. I do want to congratulate the administration for moving forward with IRAs. I think it is an important initiative. It does not go as far as I think it should, but it is certainly a step in the right direction. I want to thank you.

Senator MOYNIHAN. Mr. Chairman, before the press table empties out, now, hold right where you are. I just want to make one last moment.

Secretary RUBIN. It is an interference with their First Amendment rights, and I want it duly noted.

Senator MOYNIHAN. Right. There you are, exactly the spirit in which I vow to read a passage from this week's New Yorker. It has a wonderful review of Roy Jenkins' biography of Gladstone, who, we can probably agree, was the greatest of the 19th century prime ministers. There was this paragraph, "The 1853 budget speech made Gladstone's reputation. It was not just the policy, it was the tone. He turned the budget from the caboose of government into its engine, creating the Robert Rubin role, the man who knows the numbers and, knowing the numbers, cannot be moved." That is pretty good for mid-passage, is it not? [Laughter.]

Thank you very much. I hope you feel better.

The CHAIRMAN. Any comments?

Secretary RUBIN. Thank you.

The CHAIRMAN. Thank you, Mr. Secretary, the committee is in recess.

[Whereupon, at 11:52 p.m., the hearing was concluded.]

APPENDIX

Additional Material Submitted for the Record

Treasury Secretary Robert E. Rubin
Statement before the
Senate Finance Committee

Mr. Chairman, I appreciate this opportunity to appear today to discuss the President's budget proposal for fiscal year 1998.

This weekend I was in Berlin for a meeting of our G-7 economic partners. It wasn't so long ago when the other industrial nations roundly criticized the United States at G-7 meetings for not attending to its economic affairs and we were viewed as yesterday's economy. That situation is now exactly the opposite. The United States is once again viewed as the world's economic leader.

They understand that the primary source of U.S. economic strength today results from having squarely faced our challenges -- in both the private and public sectors-- including dramatic progress in restoring fiscal order. In Berlin, we also discussed the issues which the President emphasized in his State of the Union: how the globalization of the economy and the information revolution has made it more important than ever to have an educated workforce; how we must initiate policies which will bring more people into the economic mainstream; and how essential it is for all nations to remain engaged in the world. Meeting these challenges will further advance U.S. economic strength going forward, and that is the right path for the rest of the world as well.

It is in this context that I want to talk about the President's budget this morning.

We are in strong economic shape today and within striking distance of balancing the budget. This would not have happened without the deficit reduction program enacted in 1993, which has reduced the size of the deficit from 4.7% to 1.4% of GDP. That deficit reduction, in turn, inspired broad business confidence and drove down interest rates, which then drove and sustained the economic recovery. In fact, the United States now has the best economic conditions among all of the developed major industrial nations. Our economy has created over 11 million new jobs since 1993; inflation has remained low; exports are booming; and we've experienced record levels of investment, which is critical to future productivity. And just as deficit reduction has been the critical factor in these economic conditions, so is it critical to a strong economy over the long-term.

We have an historic opportunity to work together and finish the job. There is strong support among the public for balancing the budget and there is, I believe, a change of attitude in Washington about the importance of fiscal responsibility. Moreover, the global capital markets have created a powerful new incentive for fiscal order, by punishing fiscal laxity with high interest rates that are inimical to economic health. We can, should and must work together to capitalize on this moment and get the job done.

The President's budget will get us to balance by 2002. It does so using real numbers and no gimmicks while protecting our priorities and investing in our people. In prior Administrations, budgets were too often based on rosy economic scenarios-- and, when the actual deficits came in much higher than projected, the result was not only a higher deficit but increased public cynicism about the ability of the government to get its fiscal house in order. Under President Clinton, we have used prudent and realistic economic assumptions. As a result, actual deficits have come in lower than either OMB or CBO have projected in each of the last four years, which, I believe, is unprecedented. Our 1998 budget is done in the same spirit of sound policies and prudent, realistic economic and technical assumptions.

Our budget makes tough choices. It eliminates 254 programs outright for $2.9 billion in savings, combs discretionary spending, auctions broadcast spectrum, and contains a number of proposals to close corporate loopholes and improve compliance. Our proposal cuts Medicare spending by $100 billion over five years, but without adversely affecting the quality of care for beneficiaries or the amount they must pay out-of-pocket. In the absence of change, the Part A Hospital Trust Fund will become insolvent in 2001. The President's proposal extends the solvency of the Part A trust fund to 2007. At the same time, we recognize that there are obviously long term entitlement problems due to demographic trends such as the aging of the baby boomers, which we must address through a bipartisan process.

Mr. Chairman, as the President said in his State of the Union Address, balancing the budget requires votes by Congress, and the President's signature. It does not require a balanced budget amendment. Indeed, as strongly committed as the President is to a balanced budget, he has an equally strong conviction, which I firmly share, that a balanced budget amendment is a threat to our economic health and should not be adopted. Such an amendment will not make for us the tough policy choices that we ourselves must make to balance the budget, and it will subject our economy to unacceptable risks.

Within the context of moving toward a balanced budget it is extremely important that we invest in areas critical to future productivity and U.S. global leadership. There are, obviously, many specific initiatives in the budget worth mentioning, and most of them were mentioned last week by OMB Director Raines in his testimony before the Senate Budget Committee. but today I would like to focus on just a few significant ones -- the President's proposals aimed at giving middle class people the opportunity to obtain the skills they need to prosper in this economy, as well as proposals to move the residents of our inner cities and distressed rural areas into the economic mainstream.

First, the President's tax program provides targeted tax cuts for the middle class.

The Administration's program would make it easier for middle class families to raise children, save for retirement, and pay for post-secondary education. In addition, the Administration is proposing to eliminate capital gains taxes for nearly all homeowners when they sell their home.

The President is proposing tax cuts that total $100 billion over five years. I believe that amount strikes the correct balance between advancing the goals of a balanced budget, and providing tax relief. Tax cuts that are much higher than the Presidents' proposals would require us to make program reductions that would unduly harm our economy and our society. In many areas, the Congressional budget and the Presidential budget ~~are~~ close: not on tax cuts. I hope we can close this gap. What we should not do is engage in a "bidding war" over tax cuts.

Second. the President's budget bolsters areas critical to future productivity. The surest way to enhance productivity, and maintain our country's competitive edge in the future, is by investing in areas that have long term payoffs. To that end. the Administration proposes extending the R&D tax credit for another year; substantial additional spending on education and training; a new effort to ensure health care for children; and new initiatives to encourage businesses to hire former welfare recipients and to help states and cities locate jobs to move families from welfare to work. I mention moving families from welfare to work in the context of enhancing productivity because I believe that bringing welfare recipients into the economic mainstream and eliminating the social costs associated with welfare is critical to the future economic growth of the country and affects everyone. Welfare reform *is* an economic issue, as well as a social issue. Revitalizing our cities and moving welfare recipients to work is part of a much broader effort to bring the economically disenfranchised, many of whom are not welfare recipients, into the economic mainstream. The budget contains tax incentives to clean up environmentally contaminated land in distressed areas, known as brownfields: new empowerment zones; and increased investments in Treasury's CDFI fund. This is the right time to implement these leaner, private-sector oriented approaches toward fostering growth in the inner cities as we move to balance the budget.

The final area I wish to mention regards the importance of providing adequate resources to maintain U.S. leadership in the global economy.

The budget seeks a significant increase in overall funding to sustain our international engagement, and our rôle, as the President says, as the world's indispensable nation. To shape world events to advance our security and economic self-interest, we must meet our international obligations and support and lead in the United Nations and in the international financial institutions, such as the World Bank, the International Development Association and the International Monetary Fund. We should do so not for charitable reasons, but because it is in the economic self-interest and national security self-interest of the United States and our citizens. Bringing developing countries into the economic mainstream raises living standards, promotes political stability -- and it increases markets for U.S. exports.

Mr. Chairman, as I said earlier, I believe we have an historic opportunity to complete the job we started in 1993 and balance the budget; and to do so in a way that protects our priorities, both for now and the future. Let me conclude by thanking you again for this opportunity to discuss the President's budget proposal. I look forward to working with all of you this year.

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APPENDIX: SUMMARY OF TAX PROVISIONS

The President's FY 1998 budget provides much-needed tax relief for middle-income families, and tax incentives to boost investment in distressed areas and promote hiring of the economically disadvantaged. It also eliminates unwarranted corporate tax subsidies, closes tax loopholes, and improves tax compliance, and it reinstates the expired excise and other taxes that are dedicated to various trust funds.

Middle Class Bill of Rights

These tax cuts will help middle-class families pay their bills, raise their children and send them to college, upgrade their own skills, and plan for retirement.

$500 Child Tax Credit. Taxpayers would receive a $500 nonrefundable credit ($300 in 1997, 1998 and 1999) for each dependent child under the age of 13. The credit would be phased-out for taxpayers with adjusted gross income (AGI) between $60,000 and $75,000. Beginning in 2001, both the amount of the credit and the phase-out range would be indexed for inflation.

Education and Training Incentives. The Budget provides carefully targeted education and training incentives to make postsecondary education more accessible for middle-income Americans and to make 14 years of education the norm.

> *HOPE Scholarship Tax Credits.* Taxpayers would be able to claim a nonrefundable tax credit of up to $1,500 per year (indexed for inflation beginning in 1998) for two years, to cover tuition and fees for themselves, their spouses, or their dependents while enrolled at least half-time in the first two academic years of a degree program. To take the credit in the second year, the student must have attained the equivalent of at least a B minus grade point average in course work completed before that year. No credit is available if the student is convicted of a drug-related felony. Federal grants (but not loans or work-study payments) reduce the allowable credit. The credit is phased out for families filing a joint return with modified AGI between $80,000 and $100,000 (between $50,000 and $70,000 for single filers), indexed for inflation beginning in 2001. The credit would apply to course work beginning after June 1997.
>
> *Education and Job Training Tax Deduction.* As an alternative to the HOPE scholarship, taxpayers could elect to deduct up to $10,000 per year ($5,000 in 1997 and 1998) of tuition and fees for students enrolled at least half-time in a degree program or for courses to improve job skills. The deduction is taken in determining AGI, so it is available to all taxpayers whether or not they itemize. Unlike the HOPE Scholarship credit, which is calculated per-student, the deduction does not vary with the number of students in a family. The deduction is phased out at the same income levels as the HOPE Scholarship credit and would apply to course work beginning after June 1997.

Expanded Tax-Free Treatment for Forgiveness of Student Loans. The Budget eliminates the tax liability that normally arises when debt is forgiven, if the lender is a charitable or educational institution that lends money to a student to pay for education and then forgives the loan after the student fulfills a commitment to perform community or public service at low pay for a certain period of time. The same tax-free treatment would also apply when the Federal government forgives a loan made through the direct student loan program for a student who has been making income-contingent repayments for an extended period.

Tax-Free Employer-Provided Educational Assistance. Currently, up to $5,250 of tuition paid by an employer pursuant to a qualified educational assistance program need not be included in the income of the employee. However, the exclusion for undergraduate education expires in mid-1997, and the exclusion ceased to apply to graduate-level courses after mid-1996. The budget would reinstate the exclusion for graduate-level assistance retroactive to its prior expiration, and would extend both undergraduate- and graduate-level assistance through December 31, 2000.

Ten Percent Tax Credit to Small Businesses that Provide Educational Assistance to Employees. For taxable years beginning after December 31, 1997, and before January 1, 2001, small businesses (employers with average annual gross receipts of $10 million or less for the prior three years) would be allowed a 10 percent income tax credit for payments for education of employees by third parties under an employer-provided educational assistance program.

Expansion of Individual Retirement Accounts. The Budget expands the availability of deductible individual retirement accounts (IRAs) by doubling, over time, the current income limits for deductible contributions. In 1997 through 1999, eligibility would be phased out for couples filing joint returns with AGI between $70,000 and $90,000 ($45,000 and $65,000 for single filers). Beginning in 2000, eligibility would be phased out for couples filing joint returns with AGI between $80,000 and $100,000 ($50,000 and $70,000 for single filers). The income phaseout, as well as the $2,000 annual contribution limit, would be indexed for inflation beginning in 2001. As under current law, any individual who is not an active participant and whose spouse is not an active participant in an employer-sponsored plan would be eligible for deductible IRAs without regard to their income.

In addition, beginning in 1997, taxpayers would have the option of either deducting the amount deposited in an IRA account, or foregoing an immediate deduction and be free of tax and penalties when the funds are withdrawn from a new Special IRA, provided the funds remain in the Special IRA for at least five years.

Finally, penalty-free early withdrawals from either type of IRA would be expanded to include withdrawals to pay for higher education costs, first-home purchases, long-term unemployment, and catastrophic medical costs of certain family members not covered under current law.

Exclusion of Gain on Sale of a Principal Residence. The Budget provides substantial simplification and tax relief for millions of Americans by replacing the current-law tax treatment of capital gains on home sales with an exclusion of up to $500,000 of gain for married taxpayers filing joint returns ($250,000 for other taxpayers). The exclusion is available every two years, so long as the taxpayer used the house as a principal residence for at least two of the five years prior to the sale. The exclusion generally applies to sales on or after January 1, 1997.

Empowering Communities and the Economically Disadvantaged

The Budget will spur private-sector participation in revitalizing distressed communities and generate job opportunities for long-term welfare recipients.

Tax Incentives to Clean Up Blighted "Brownfields" in Distressed Areas. To encourage companies to clean up abandoned, contaminated industrial properties located in distressed communities, remediation costs incurred in connection with the abatement or control of certain environmental contaminants would be immediately deductible if incurred for a qualified site. Qualified sites include business or income-producing properties located in specified high-poverty areas where it has been certified that hazardous substances are present or potentially present in the property. The deduction would be subject to recapture as ordinary income upon a subsequent disposition of the property at a gain. The proposal would apply to expenses incurred after the date of enactment.

Additional Empowerment Zones and Enterprise Communities. The Secretary of Housing and Urban Development would be authorized to designate two urban empowerment zones in addition to the six urban and three rural zones designated on December 21, 1994. This would have the effect of extending the current empowerment zone tax incentives to these additional areas, with technical modifications. In addition, 20 additional empowerment zones and 80 additional enterprise communities, which will be subject to modified eligibility criteria, would be authorized. These additional zones would have available a different combination of tax incentives than those available to existing zones. Among the 20 zones, 15 would be in urban areas and 5 would be in rural areas. The 80 communities would be divided between 50 urban areas and 30 rural areas. Areas within Indian reservations would be eligible for designation.

Tax Credits for Community-Oriented Equity Investments. The Community Development Banking and Financial Institutions Act of 1994 created the Community Development Financial Institutions (CDFI) Fund to provide equity investments, grants, loans, and technical assistance to financial institutions that have community development as their primary mission. The Budget would make $100 million in nonrefundable tax credits available to the CDFI Fund to allocate among equity investors between 1997 and 2006. The allocation of credits is capped at 25 percent of the amount invested in any project and would be determined by the CDFI Fund using a competitive process.

Tax Credits to Facilitate the Transition from Welfare to Work. The goal of the Welfare Reform Act of 1996 (the Welfare Act) is to move individuals from welfare to work. To help achieve this goal, the Budget includes a new welfare-to-work credit that would enable employers to claim a 50-percent credit on the first $10,000 of annual wages paid to certain long-term public assistance recipients for up to two years. In addition, the Budget would expand the existing Work Opportunity Tax Credit to include able-bodied adults, ages 18-50, who have met their responsibilities under the law but are subject to the time limits for food stamps under the Administration's proposal to amend the Welfare Act. These proposals would be effective from the date of enactment through September 30, 2000.

<u>Estate Tax Relief for Small Businesses and Farms</u>

Under current law, estate tax attributable to certain closely held businesses may be paid in installments (interest-only for four years, followed by up to ten annual installments of principal and interest). A special four-percent interest rate is provided for the tax deferred on the first $1 million of value. Only certain types of business arrangements are eligible for the installment payment provision, and a special estate tax lien applies to property on which the tax is deferred during the installment payment period. The Budget increases the value cap on the special low interest rate from $1 million to $2.5 million, expands the availability of these rules to other comparable business arrangements, and authorizes the Secretary to accept security arrangements in lieu of the special estate tax lien. These proposals would be effective for decedents dying after 1997.

<u>Other Tax Relief Provisions</u>

Extension of Expiring Tax Provisions. The Budget would extend each of the following provisions for one year from their current expiration date:

- The 20-percent credit for research and experimentation expenditures (expiring May 31, 1997);
- The 35-percent Work Opportunity Tax Credit for employment of targeted hard-to-employ groups (expiring September 30, 1997);
- The 50-percent credit for qualified clinical testing of certain drugs for rare diseases or conditions (known as "orphan drugs") (expiring May 31, 1997);

and

- The fair-market-value deduction allowed for contributions of appreciated stock to private foundations (expiring May 31, 1997).

Equitable Tolling of the Statute of Limitations. To ensure that disabled persons are fairly treated when filing for tax refunds, the statute of limitations for refunds from the Internal Revenue Service would be delayed when the individual is under a sufficient medically determined disability and no other person has been authorized to act on the taxpayer's behalf in financial matters. The proposal would be effective for taxable years ending after the date of enactment.

Tax Incentives for Economic Development of the District of Columbia. To encourage employment of disadvantaged residents and to revitalize those D.C. areas where development has been inadequate, tax incentives are proposed.

Tax Credit for Economic Development of Puerto Rico. To provide a more efficient and effective tax incentive for the economic development of Puerto Rico, the Budget modifies the economic-activity credit for Puerto Rico by extending it indefinitely, opening it to newly established business operations, and removing the income cap.

Foreign Sales Corporation (FSC) Benefits for Computer Software Licenses. To reflect technological advancements, the Budget extends the current FSC export benefit to include computer software licensed for reproduction abroad, effective for licenses granted after the date of enactment.

<u>Closing Corporate Tax Loopholes and Other Revenue Measures</u>

The Budget includes proposals previously proposed by the Administration to eliminate unwarranted corporate tax subsidies, close tax loopholes, and improve tax compliance. Such measures include:

- Proposals focused on financial products, to maintain the distinction between debt and equity, curtail arbitrage opportunities, prevent avoidance of gain recognition on functional sales, and properly measure income;

- Proposals focused on corporate transactions, to prevent tax-free disguised sales of businesses, prevent the manipulation of the stock redemption rules to distort income, eliminate the use of inventory methods that mismeasure income, and reduce corporate subsidies such as percentage depletion on lands received from the Federal government at a bargain price;

- Proposals focused on the international tax rules, to measure export income more accurately, prevent manipulation of the foreign tax credit rules through artificial labels, and eliminate distortions resulting from the use of derivative financial instruments; and

Proposals focused on increasing tax compliance, for example by tightening the substantial understatement penalty for very large corporations, expanding withholding on gambling winnings, and streamlining debt collection procedures for non-means tested, recurring Federal payments.

Extension of Expired Excise and Other Trust Fund Taxes. The Budget also proposes reinstatement of the excise and other trust fund taxes that have expired: the Airport and Airways Trust Fund excise taxes; the Hazardous Substance Superfund Trust Fund excise and income taxes; the Oilspill Liability Trust Fund excise taxes; and the Leaking Underground Storage Tank Trust Fund excise tax. These are not new taxes: they have been applied for years to finance specific programs, such as the provision of air traffic control services and the cleanup of certain hazardous waste sites. Each of these taxes would be extended through 2007.

Tax Simplification and Taxpayers' Rights

The Administration continues to support revenue-neutral initiatives designed to promote sensible and equitable administration of the tax laws, including simplification, technical corrections, compliance, and taxpayers' rights measures. In the near future, the Administration will propose to Congress a package of such measures.

ISBN 0-16-057940-6

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