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REVENUE PROPOSALS IN THE PRESIDENT'S FISCAL YEAR 2005 BUDGET

HEARING

BEFORE THE

COMMITTEE ON FINANCE
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CONTENTS

OPENING STATEMENTS

ADMINISTRATION WITNESSES

ALPHABETICAL LISTING AND APPENDIX MATERIAL

COMMUNICATIONS

REVENUE PROPOSALS IN THE PRESIDENT'S FISCAL YEAR 2005 BUDGET

THURSDAY, FEBRUARY 12, 2004

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

The hearing was convened, pursuant to notice, at 2:06 p.m., in room SD–215, Dirksen Senate Office Building, Hon. Charles E. Grassley (chairman of the committee) presiding.

Also present: Senators Hatch, Lott, Snowe, Thomas, Santorum, Smith, Baucus, Conrad, Bingaman, and Lincoln.

OPENING STATEMENT OF HON. CHARLES E. GRASSLEY, A U.S. SENATOR FROM IOWA, CHAIRMAN, COMMITTEE ON FINANCE

The CHAIRMAN. It is a privilege to have the Secretary of Treasury before us. This is a make-up for a meeting that was canceled because of the ricin scare of a week or so ago. We are going to hear from the Secretary on the revenue proposals of President George W. Bush's fourth budget. That budget covers fiscal year 2005. I welcome Secretary Snow back to our committee.

Senator Baucus and I, and other members of the committee, Mr. Secretary, find ourselves with a great many challenges. People expect us to take these challenges seriously, and I am confident that we will respond constructively.

The Finance Committee faces several major challenges. Foremost among those, we need to respond to the WTO ruling against the Foreign Sales Corporation replacement regime that we have recently, 3 years ago, passed called ETI. In addition, we hope to address welfare reform and additional trade agreements.

On the two principal tasks, the Finance Committee has taken the first step. Last fall, we reported FSC/ETI replacement legislation and welfare reform. The FSC/ETI replacement regime came out of this committee overwhelmingly, bipartisan, 19 to 2.

We have the momentum and seek floor time from the Majority Leader, and I hope that we can do it so that we show the European Union, at least on the Senate side, that we are encouraging them not to impose sanctions on the time their law calls for, March 1 of this year.

Even in a leap year, with the extra day in the month, we are talking about a little more than 2 weeks away. We have to take the sanctions seriously. There are rumors that some in the other body pooh-pooh the threats, saying that the phase-in schedule is no big deal.

I would like to be clear on that point. I want clear sailing for expanding trade. Gambling with sanctions, if true, will bring a stormy environment to our efforts to expand trade.

Gambling with sanctions is tantamount to playing with fire, because they understand where our soft underbellies are. One of those happens to be agriculture, very much an interest to most of the members of this committee, particularly Senator Baucus and me.

So, first off, Mr. Secretary, I hope that you can assure me that the administration agrees that we need to move FSC/ETI replacement very quickly.

On welfare reform, likewise, I hope that we get time to meet the deadline that we advanced from last fall to March 31 of this year.

We also have not finished the job on tax relief for American workers, families, and small business folks. Under 2001 and 2003 tax relief bills, there is a sunset on tax relief. It is only fair to make this tax relief seamless and permanent.

I do not think anyone wants to see middle income families of four see their taxes rise by at least $600 next year if we do not take action, at least on part of those tax bills. That is what we will face if we do not extend the Child Tax Credit increase and other family tax relief provisions.

Now we have to tackle tasks at hand with rising deficits. Like any Iowan, I get nervous to see the red ink over the last term. The Federal Government, just like any Iowa family, has to live within its means.

There are some differences in how we achieve the objective of deficit reduction. One thing I would like to do today is to set the record straight on recent changes of revenue and spending.

Contrary to what one often reads or hears, revenues are projected to stay at, or near historical averages. The spending side of the ledger, however, has ballooned. I am looking forward to hearing from you, Mr. Secretary, an outline of how the administration plans to get the deficit under control.

Before we finish this legislative session, I hope that we will be able to enact into law pension reform along the problems that have been surfaced because of Enron and Worldcom.

As we move into this legislative session, I want to emphasize that we should pursue these issues, where possible, in unity. As the presidential campaign heats up, many seem to have the impulse to divide workers from business owners, consumers from investors.

But these are complementary activities; you cannot have one without the other. We cannot ignore consumers and workers who have kept the economy going. In the same manner, we cannot ignore business owners or investors who create jobs through their investment.

The Finance Committee will keep an eye on using the people's tax dollars wisely. We will have to operate within the confines of the Budget Resolution that Chairman Nickles produces.

On that score, the Finance Committee is the only committee in Congress producing significant offsets. If there is good tax policy, like curtailing tax shelters, and it produces revenues, we intend to pursue it.

I am pleased, Mr. Secretary, for instance, that your own Treasury Department joins us in shutting down some of the municipal sales lease back scams.

As is always the case, I anticipate the bipartisan cooperation that is the tradition of this fine committee. The American people expect us to focus on their problems and not on our political agenda.

Now, except for going to Senator Baucus, who has gone over to vote, and when he comes back I will go vote, we will go to your statement.

STATEMENT OF HON. JOHN W. SNOW, SECRETARY, U.S. DEPARTMENT OF THE TREASURY, WASHINGTON, DC

Secretary SNOW. Thank you. Thank you very much, Mr. Chairman. It is a pleasure to be here before you and the committee. Senator Lott, pleasure to be here with you.

A year ago when I appeared before the committee at this time, the American economy was in a very different position. There was talk of a double-dip recession, there was talk of deflation. Even those who saw the economy in pretty good shape characterized it as a wobbly recovery, an anemic recovery, a weak recovery.

Thanks to the actions which you took in passing the President's Jobs and Growth bill, the economy is now in a strong recovery, with GDP growth rates in the third quarter of 8.2 percent, and for the year as a whole, 4.3 percent, with all the private forecasts talking about 4 percent plus for the 2004 year.

Exports are up. The manufacturing sector is beginning to come back. The housing industry is very strong. Construction is very strong. We are beginning to see some—too slow, but some—comeback in the labor markets.

By sustaining this growth going forward, I am confident that we will see good jobs pick up in the months ahead, as indicated by all the private sector surveys which indicate job growth on the order of several million jobs over the course of the next year.

I mention all that because it is important to make the tax cuts permanent. The tax cuts have been the linchpin of the improving performance of the economy, and making those tax cuts permanent is the surest thing we can do to sustain the economy on a good, strong growth path for this year and for the years beyond, the out years. I am confident that if we do that, we are going to continue to have above-normal growth for the American economy for a good spell ahead of us.

A word on the deficits. They are too large by far, they are unwelcome, and we are going to do something about them. The President's budget calls for cutting the deficit in half over the course of the next 5 years.

Now, large and unwelcome as they are, they are understandable. They are understandable in the sense that the President inherited a recession. That required tax action to sort of sustain the American economy through a very difficult period. It would have been a lot more difficult but for the action of the Congress. I commend you for that.

Then we got 9/11 and we had the melt-down of the equity markets, the Nasdaq and the S&P, and $7 trillion disappeared from the net worth of America, a huge shock to the system, and the corporate scandals which rocked investors' confidence in equity markets and in the system.

Of course, then we had the war in Afghanistan to go after the Taliban, and then the Iraqi encounter, all of which have taken their measure, their toll on the economy. Despite that, we are coming through it.

When I talk to business people from other parts of the world, Europe particularly, finance ministers from other parts of the world, they are in amazement that the United States' economy could have performed as well as it has in the face of these assaults, these shocks.

The reason it has performed so well, is the adaptability of our institutions, including the actions of the Congress in making sure that aggregate demand was strong enough to pull us through those rough spots.

A couple other points, Mr. Chairman. On FSC/ETI, we can go into it in more detail, but we are committed to working with you and seeing that brought into law. We need to be in conformity with the WTO rules and we should do it before the sanctions come into effect. To use your phrase, we are playing with fire on those trade sanctions.

You also mentioned pension reform. That is critically important that we come forward with actions on the pension front, putting in place, we hope, a permanent solution, but at the very least a 2-year/3-year fix on the discount rate.

I would hope the Congress, having acted last year to put in place the HSAs, would follow through with other savings vehicles, the so-called LSAs and RSAs and small employer ERSAs to help savings in the country, because with a 2 percent personal savings as a fraction of personal income, we are way, way, way low on that score.

So, I thank you again for the chance to be with you. Let me just mention again the four priorities in the budget. One, is to win the war on terror. That is funded heavily. And protecting the homeland. Defense is up some 7 percent, homeland security up 10 percent.

Strengthening the economy, making the tax cuts permanent, and cutting the deficit in half. Those are the major themes of this budget, and I thank you.

[The prepared statement of Secretary Snow appears in the appendix.]

Senator LOTT. Secretary Snow, I just want to thank you for being here. We have this vote going on.

Secretary SNOW. I understand, Senator. Thank you.

The CHAIRMAN. I am going to go vote. But if you will just stay there, when Senator Baucus comes back he will reconvene the hearing immediately and proceed at that point, probably with his questioning or comments. So, just temporarily.

Secretary SNOW. Thank you.

[Whereupon, at 2:18 p.m., the hearing was recessed to reconvene at 2:28 p.m.]

Senator BAUCUS. The hearing will reconvene.

I strongly suspect the Chairman will return very quickly. In the meantime, he has asked me to proceed so as not to waste the time of the Secretary, and also of the Senators.

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

Senator BAUCUS. I have a short statement, Mr. Secretary. First, I am very pleased that you are here and I regret that we had to postpone the earlier hearing. Thank you very much for taking the time to appear before us and answer some of the questions that we have in pursuit of our obligation as members of Congress to determine what the executive branch has in mind.

Mr. Secretary, I support a number of the proposals in the President's budget, and I am heartened that the administration has acknowledged that we need to do something about the deficit. But, quite frankly, I am concerned that a good, honest, solid plan to balance the budget is notably absent.

This budget, I believe, is fiscally unsound. It will leave us with a $521 billion deficit this year. This is almost $150 billion more than the previous record deficit set just last year.

Of even greater consequence are the continuing deficits proposed for the years ahead. These deficits will raise interest rates. They will slow economic growth and will leave Americans poorer.

One example. A recent Brookings Institute study projected that continuing to run deficits of 3 percent of the economy would raise mortgage interest rates by a full percentage point.

Continuing deficits would thus increase the annual payments on a typical mortgage by about $2,000 a year, in effect, the equivalent of a $2,000-a-year tax increase on American homeowners.

The Federal Government's finances work something like those of a household that borrows money from a bank. It is not exactly the same, but it is the same basic principle.

The household borrows more and more money from the bank, and at some point the bank refuses to lend any more money simply because the bank will be concerned that the household will not pay the money back.

The same is generally true for our country. If we continue to borrow money from both domestic and foreign sources, as we do, at some point, some lenders, especially foreign lenders, will begin to worry about whether the United States will pay all that debt back.

At some point, these lenders may stop lending or demand a much higher rate of interest in exchange for lending to the United States. There is great concern that Chinese holdings, Japanese, and other countries' put us in a very dangerous position because they are poised to put that kind of leverage on us, and that is probably at a date sooner than many of us would like to realize.

Those higher interest rates will slow business investments. That will slow growth. We know doggone well that current low interest rates and current low rates of inflation will not last forever. It is clear that continuing deficits and debt will sooner, rather than later, raise those interest rates, and that will then have an effect on our inflation rates.

Slower growth means fewer and less well-paying jobs. American people will be poorer because of those deficits. Yes, this budget presents deficit projections for the next 5 years, through 2009, that trend down to $327 billion.

Mr. Secretary, I think there are several reasons why these projects are unlikely to hold true. First, they leave out any proposals to fix the Alternative Minimum Tax, shorthand, AMT, beyond a short-term fix. Under current law, about 27 million filers would have their taxes raised by the AMT in 2009. I do not know anyone who has studied this issue who believes that the President and the Congress will let that happen. We will not.

To fix the problem in fiscal year 2009 would cost $58 billion in that year alone, but the President's budget does not include any dollars for that problem.

Second, the President's estimate of the 2009 deficit allows total discretionary spending to increase by only 4 percent a year. That is total discretionary domestic by 4 percent a year.

With all due respect, Mr. Secretary, I think that is quite unrealistic, given expected and needed growth in military spending, homeland security, et cetera. Allowing total discretionary spending to grow by even 5 percent a year, would add approximately $50 billion to the budget deficit for 2009.

We must keep in mind that, for the last 5 years, total domestic discretionary has risen by about 7 percent a year, and that does not include the $87 billion of military supplemental.

So if you look at history, it has risen by roughly 7 percent a year, and that does not include, as I said, the $87 billion for military supplemental, and who knows what other supplementals are going to be requested by the administration.

So if we plan for the AMT and increased discretionary spending, you will see a deficit in 2009 of approximately $350 billion. That is more than $100 billion above the administration's prediction. This is almost three-quarters of the deficit in 2004, not half, as the President promised.

So, realistically, looking at the cost of fixing the AMT, and looking at history as a guide with discretionary spending, the deficits will in fact be—and I am probably being conservative about this—actually much, much higher than mentioned in the President's budget.

But of even greater importance, running a 2009 deficit, conservatively, of $350 billion, I believe, is reckless for a lot of reasons. Basically when the baby boom generation retires in 2008, just 4 years from now, there will be tremendous additional demands on the budget that we are not contemplating today, and certainly not contemplating in the deficit projection. Rather, we are thinking short-term instead of long-term.

To cope with the pressures from the baby boom's retirement, we need to put the government, I believe, on a glide path to a balanced budget. That would be fiscally responsible.

Just think of the signal, the psychological signal, that would send to the country, to Americans, and to the world. People would think, hey, those guys in Washington, they are finally getting their act together. They are being responsible with our money, that is, the taxpayers' money.

I believe that is a very potent and positive signal that creates job, that creates confidence. People believe more in the future. This deficit, to be honest, is going not only the wrong direction, it is going much more in the wrong direction than is presented in the budget.

As I mentioned, rather than propose a balanced budget for 2009, the President's budget proposes a deficit of $237 billion, which, conservatively, I believe is at least $350 billion, and likely more. And the budget's glide path, in 2009 is going pretty much in the wrong direction.

One of the reasons that the President's budget would lead to a $530 billion deficit in 2014 is that the administration also wants the Congress to make all of the 2001 and 2003 tax cuts permanent.

It would be much more responsible—after all, that is supposedly why we are here, to be responsible—to wait to make those decisions about permanence of these tax cuts when we know the state of the economy. That is, wait a few years. Maybe it makes sense if we make that decision closer to when they are expiring instead of today.

In addition, when the economy is so deep in the red, we should ensure that any additional spending and tax cuts are paid for. I encourage the President, frankly, to take another look at our deficit—he has sometimes taken another look, I have noticed in recent years, at different situations—before pushing for an unpaid, permanent extension of the tax cuts.

In addition to making the tax cuts permanent, the President has also proposed programs that will significantly add to the deficit and not directly aid our economy. The administration proposes to put people on Mars and an outpost on the moon, costing hundreds of billions of dollars, hundreds of billions of dollars we do not now have.

In addition, the President, in his State of the Union address, proposed partial privatization of Social Security. Any such proposal would likely keep the current Social Security system for all workers who are age 55 or older. After all, they are already in the system so we are probably going to keep them in.

And you know as well as I that there would be huge transition costs to the Federal Government over the next several decades just to maintain those benefits for those beneficiaries who are still in the current system. The general estimates are about $1 trillion, the transition costs to go to partial privatization, in addition to all of the costs that we now have.

The economic report of the President released this week verifies the magnitude of those transition costs, stating that by the year 2041 these costs will require an increase in the Federal debt held by the public of $4.7 trillion in today's dollars.

That is an increase that would be larger than the entire $4.1 trillion of debt held by the public today. We know we are going to have to face these problems, essentially the baby boomer problems.

Mr. Secretary, I, for the life of me, must plead that you, the President, the administration to start honestly addressing this. That would create a lot of additional confidence.

People are not dumb. They know what is going on. They are smart. They know there is a baby boom generation coming up. The failure to address it, just continuing to put it off under the rug, I think, tends to undermine public confidence in government.

If the administration were to address it solidly, I think that would certainly cause big choices, trade-offs, and we would have to prioritize. But, because we would be doing the right thing, being honest about the problem, it would create a lot more confidence in government.

The budget also includes even more. A proposal to create new lifetime savings accounts, new retirement savings accounts. While this proposal would have small budgetary costs, as you know, between now and 2014, that is not the real problem. The real problem is the cost that that would have after 2014 in later years. One estimate puts the annual cost of those in 2030 at $30 billion. That is a half a percent of GDP, just alone.

Faced with retirement of the baby boom generation, I believe these three proposals show a surprising lack of discipline. In contrast, when previous administrations of both parties were faced with high deficits, they made it a priority to reduce them. It was tough, very tough, and had consequences. Most of them were positive, some of them not so positive, but it had consequences. They may not have always succeeded, but at least they tried.

I am also very concerned that this budget does little to help those who need it the most. For example, the budget proposes tax cuts that are supposed to help low- and moderate-income individuals who have no health insurance from their employers.

Unfortunately, if one looks beyond that and looks at the facts and digs down a little deeper, this proposal would likely lead people to face the costly individual insurance market without providing them with sufficient assistance to purchase the coverage they need.

Moreover, the tax cuts would subsidize the individual insurance market, even though it tends to provide insurance to only the young or the healthy. They are the ones who tend to take advantage of it, not the folks who really need it.

At the same time, this budget does little for workers who do not have jobs. In particular, it does not provide tax relief to the manufacturing industry, which has lost jobs for 42 straight months.

In contrast, Senator Grassley and I have aggressively pushed a domestic manufacturing tax package, the FSC/ETI replacement bill, which I know the administration generally supports. But I would like to see the administration get behind that, because that is a jobs bill and we need jobs. Let us get that passed right away.

The budget also does not provide enough money for constructing new highways, even though the highway construction program creates jobs. I, for the life of me, cannot begin to fathom any reasons why the administration even suggests potentially vetoing this highway bill, even at the amount is contained in the Senate. He has never vetoed a bill yet.

He is certainly not going to veto a highway bill. But yet he talks about vetoing the highway bill. He should place his veto threats elsewhere in a better place, not on this bill, which basically does not add to the budget deficit at all. In a small way it does, but it is peanuts compared with the way other programs do.

I have spoken a little longer than I probably should have, Mr. Secretary. But I just want to sum up with this. I believe very strongly that we in the United States have got to get our economic house in order.

Now, maybe I am going too far here, but years ago when I read a book by Paul Kennedy I was struck with the basic thesis of that book, which is that in the sweep of history, countries tend not to fall or be defeated because of external invasions or military forces from beyond, but rather because of internal decay from within. That is basically what happens to countries.

Now, we are off to war in Iraq, but I do not think we are spending enough time focusing on the American economy. It really gets to the offshoring issue, jobs going offshore, whether it is manufacturing, service, or whatnot. It is a very complicated issue, but extremely important.

It gets to education, science, math, to job retraining, patent protection, a whole host of issues, as well as keeping jobs here. To be honest, Mr. Secretary, I tend to this that this administration is kind of asleep at the switch, at the basic economic problems we are facing in helping us do something honestly about it.

They are not going to be fixed easily. It is going to take time. But I do not see this administration beginning at all. You are going to find a committee here that wants to work with you in solving that.

The Chairman and I are known for working together, and working with the administration on matters that count. This is one that really counts—really counts—and I would just urge you to see what we can do about that this year.

Secretary SNOW. Thank you very much, Senator.

The CHAIRMAN. Now I think we are ready for questions. I would like to have five minute rounds for questions. Not everybody's name is on here, but for the names that are on here, it would be: Grassley, Baucus, Hatch, Bingaman, Lott, Smith, and Lincoln. We will get an updated list here in just a minute.

Mr. Secretary, CBO reports that in the year 2000, the Federal tax burden as a percentage of GDP, Federal taxes, took 20.9 percent, a record post-World War II level. Individual income taxes as a part of the total Federal taxation were at even more dramatic levels. CBO reported that individual income taxes were 10.3 percent of GDP.

CBO has also indicated that revenues will hit a trough at about 15.8 percent this year, but then trend back upward over a balance of the period of the tax relief plan.

CBO says that, as a percentage of GDP, revenues will return to their historically average levels over the next few years. It is also clear that if the tax relief package is not made permanent, revenues will return to, once again, our historically high levels.

For instance, in 2014, CBO says Federal taxes would hit 20.15 percent of GDP. Now we hear a lot of criticism from those who oppose the bipartisan plan. One of the main criticisms is that we cut income taxes too much. That is, the allegation is that the bipartisan tax relief plan gutted the Federal revenue base.

Do you agree with those critics? Is the only path to Federal discipline to maintain record levels of Federal taxation as a percentage of income? Is it safe to say, as these critics do, that there is no down side to future economic growth if record levels of Federal taxation continue in place, Mr. Secretary?

Secretary SNOW. Mr. Chairman, thank you. My basic answer is that our problem as a society is not that we are under taxed. Raising taxes does not solve the problems of the American economy.

It exacerbates the problems and makes it more difficult to achieve the sort of growth path we want to be on, a growth path that creates a more bountiful and prosperous life for the American citizens.

The receipts, as a percent of national income, should rise. In our budget, they do rise. With the tax cuts made permanent, they rise, but they go back to about 18 percent, which is the historic level.

By not making them permanent and, under the CBO estimate, by going to 20-plus percent again, I think we will limit the prospects for growth, limit the prospects for jobs, limit the prospects for prosperity.

So, I would strongly urge us to make the tax cuts permanent. If we do not make them permanent, it is important to recognize what happens: we have a big tax increase on the America people and we lose the benefits of lower taxes on equity capital, lower capital gains, lower dividends taxes, and lower taxes on, I think it is, 118 million taxpayers. So, I would hate to see tax receipts go back up to that 20 percent level.

The CHAIRMAN. I want to bring up an issue in my second question that relates to my belief that most new jobs are created by small business, and that anything we can do to promote small business, we ought to. We did have tax policy that had a penalty on small business, and certain candidates for president now are making arguments that we ought to reestablish that penalty.

That is because most small businesses are operated as sole proprietorships, partnerships, limited liability corporations, or S corporations. The incomes of these entities are reported directly on the individual tax returns of the owners. Therefore, individual rate cuts and reductions of taxes are very beneficial to small business.

Presently, the highest individual rate is 35 percent, the same as the corporate rate. Prior to 2001, the rate was 39.6 percent. This is a penalty on small businesses of 15 percent. Now we hear, as I indicated, some folks proposing to restore the 39.6 percent bracket. They argue we should use the revenue for health care or deficit reduction.

Would you comment on the effect of this small business rate penalty on job formation and economic growth? Then I see the warning light is on, so when you are done I will go to Senator Baucus.

Secretary SNOW. I will be brief, Senator. I think it would be a terrible mistake if that were to happen. There is no reason why small business should have higher tax rates, which would be the effect of failure to make these tax rates permanent. There is no reason why small business should have higher tax rates than big business. Small businesses are engines of job creation.

As we look at the numbers, it appears that small business is expanding well right now, in large part because of the tax reductions that affected some 23 million taxpayers who qualify as those S partnership or C entities, those flow-through entities that you mentioned.

So, I think it would be a terrible mistake and a terrible shame if we had those tax rates go back up, and prejudice small business versus larger businesses.

The CHAIRMAN. If taxing the wealthy is also putting a penalty on small business, it has got to be detrimental to the economy, and it is not necessarily taxing the wealthy.

Senator Baucus?

Senator BAUCUS. Thank you.

Mr. Secretary, the chairman of the President's Council of Economic Advisors stated—as you well know, it has been in the press lately—in effect, well, jobs going offshore, that is just the new version of trade and it is probably a good thing. Do you agree with that statement of his?

Secretary SNOW. I think you are referring to Greg Mankiw's comments of yesterday.

Senator BAUCUS. I am. I am.

Secretary SNOW. I think what Dr. Mankiw was talking about there was very much the same thing that I saw Chairman Greenspan say, that the focus has to be jobs and how we create jobs. You create jobs with a dynamic economy that rewards initiative, that rewards risk-taking, by keeping the fundamentals of this economy working well.

That is, keeping an open economy. That is keeping an economy that has flexible labor in capital markets. By doing all of that, and by rewarding entrepreneurship and keeping the channels for the new jobs of the future open, we do the very best thing for job creation.

Senator BAUCUS. I am a little concerned with that answer because I think there is some merit in that, but it does not address the problem that someone has when he or she loses his job because a large American company has gone offshore, either manufacturing or services.

I appreciate the point about entrepreneurship, and that is particularly true with smaller business and smaller enterprises. But a 40-, 45-, or 50-year-old who loses his or her job, and we know there have been 2 to 3 million jobs lost in the United States, is not terribly heartened by saying, well, we need entrepreneurship in this country.

Secretary SNOW. There was a larger point I was making. That is, we need to be concerned about jobs today and jobs tomorrow. We need to make sure that the engine of job creation is always at work. If you do not have jobs, you do not have an economy.

Senator BAUCUS. What do you say to the two million who have lost their jobs?

Secretary SNOW. What I say to them, Senator, of course, is it is extraordinarily regrettable. I am somebody who has lost a job and knows what it feels like. I have been successful in life, but I have also been on the other side of things, looking for a job and not being able to find it. Every time I read those job statistics, a piece of me goes back to that time when I was looking for work and could not find it.

Senator BAUCUS. Well, these people cannot find it either.

Secretary SNOW. Well, Senator, but what I am saying to you is, jobs get created through a dynamic and strong economy. Let me offer you, since you have asked me, some thoughts on this. First of all, you have got to have strong aggregate demand.

That is why the action that the Congress took last year in reducing tax rates across the board, giving small business the expensing opportunities, the child credits, the marriage penalty, that whole list of things, including lowering marginal tax rates, the dividend tax reduction, and the sizeable reduction in capital gains all have had a big effect. They have had a big effect in taking growth rates that were anemic up to growth rates that were 4.3 for the year.

Senator BAUCUS. All right. That is fine. What is the other?

Secretary SNOW. So, first of all, you have got to have a strong economy. Second, we need, in the United States, to continue to reward people who create the jobs of the future. That is, new ideas. People say, where are the jobs coming from? I do not know and you do not know.

But what we do know, is that if we keep open the opportunities for the innovative, for the new ideas, make sure they have got capital, make sure the workforces have access to training for the jobs of the future, we are laying the foundation for prosperity.

Senator BAUCUS. Well, I have a problem with that because you say keep the economy strong. The tax cut in 2001, particularly, was passed. You say, keeping aggregate demand strong. Still, even with all that, and there is strengthening demand, two to three million people lost their jobs. That is a fact. That is not theory. That is not an abstraction, that is a fact.

Then you talk a little bit about rewarding spirit and that kind of thing, and also a little bit about job retraining. This administration's budget, in retraining, is a pittance. I do not see in this budget any real sympathy or understanding for those who have lost their jobs, and doing anything about it.

I understand the theory and I have a lot of agreement with the theory. But I am also even more worried about those folks who have lost their jobs. To be honest with you, I do not hear the administration saying anything or coming up with anything that hits that part of the problem. It is clear this is a huge issue. It is very huge. It goes to patents, intellectual property protection, math and science in schools, retraining. It goes to all those issues.

But I do not hear from the administration sufficient understanding, sensitivity, and sympathy for those who have actually lost their jobs and have not found jobs, and doing anything about it. I am sorry, but that is how I see it.

Secretary SNOW. Senator, you have not heard the President speak on this subject then.

Senator BAUCUS. Well, I am talking about results. Words do not matter. It is deeds, not words, and I do not see the deeds.

Secretary SNOW. Senator, the best thing we can do is have a strong underlying economy with growth. Because when we have a strong economy with high growth rates, jobs follow. That is the formula we have always seen, and we will see it again.

You say, Senator, the facts. Of course, the facts are a little bit—you would have to acknowledge this, I think, with me—mysterious on this, because we have the two principal surveys showing different results.

We have the so-called establishment survey showing 2.3, 2.4 million job losses that you referenced. We have the household survey showing a different trend with a very substantial number of jobs being created.

Normally, these two surveys converge. For some reason, they are departing. It is a subject of conversation among the economists who are trying to reconcile these two.

Senator BAUCUS. I understand that.

Secretary SNOW. So, I would question you a little bit when you say the facts are clear on this. The fact is, the facts are not clear.

Senator BAUCUS. And I ask the indulgence of the Chairman just for a minute here.

The CHAIRMAN. Let us see if we can summarize in a sentence or two.

Senator BAUCUS. You mentioned two different surveys. Chairman Greenspan said the one that counts is the payroll survey, not the household survey. The payroll survey shows that jobs have been lost and are not coming back.

The CHAIRMAN. Can we go on, please? I would like to call on Senator Smith.

Senator SMITH. Thank you, Mr. Chairman.

Secretary Snow, welcome. Let me just say at the outset, I am not an economist, but before I was in politics I was an employer during the decade of the 1980's, and half of the 1990's. I employed as many as 1,200 people in a vegetable processing company.

Frankly, with that background, when I come to this position on the Finance Committee, and I hear many of my colleagues talk about the jobs that President Reagan created, or that President Clinton created, I, frankly, chuckle within myself.

Let me tell you why. Because in all of my time of running a business, I never once made an investment in plant, or equipment, or people based on who was the President of the United States. I mean, truly.

I made that decision on the basis of, could I pay the bank back? Could I make something that I could sell that would enable me to show a bottom line that was black?

So, we are not a centrally planned economy, and I pray to God we never are. Frankly, it is concerning to me, when I hear the rhetoric in a political campaign, that we have especially got to stop giving all the breaks to the top bracket, I think Chairman Grassley has hit on something I wish every American could understand, the 80/80 rule, as I read it in your material. Eighty percent of that top bracket rate goes to small business, subchapter S corporations. Eighty percent of the jobs during the Clinton administration and this administration are created by that category.

So if you want to create jobs, let me tell you, one of the calculations you make in figuring out if you can pay the bank back, is what is the tax rate? So I would suggest to you that, of all the things we can do here that can help create jobs, we have done here.

But we need to make them permanent so people, business planners, can plan on those things. Because when they can plan on it, they can re-employ people. It is not rocket science, but that is what I am experiencing. Frankly, I think that is what you are saying.

Now, to the point of tax rates, Mr. Secretary, I am worried, when I went to Philadelphia with the Republican conference and we heard our House colleagues say they are not too interested in taking up this FSC/ETI issue. They are not worried about the penalties that will be imposed on manufacturers.

I am worried about tax rates on manufacturing. Most manufacturing is not passed through the 80/80 group. They are the C corporations. The cost of C corporation business in this country is high. Whether tax rates, whether regulations or other burdens, it is high, so a lot of it is leaving. This is one benefit that is going away. I am not sure I am hearing much energy from the administration to figure out how we deal with this revenue that has been going to FSC.

How do we utilize that to the greatest advantage for manufacturing in this country? If it is not something we do in the Senate, and we cannot agree with the House or the White House, what do we do with those resources to help manufacturing?

Secretary SNOW. Senator, thank you. Let me comment on the first part of your observation, and then turn to the FSC/ETI. I agree with you completely. The great cloud on business is uncertainty. There are lots of forms of uncertainty, but one we do not need to have is tax policy. But it is not just businesses, it is taxpayers. I travel the country now and try to have symposia to talk to taxpayers.

You meet people who are schoolteachers, and nurses, and health care assistants, and information technology workers, and so on. You ask them, how did the tax cut affect you? Over and over again they say, I now know I have got an extra couple of thousand dollars a year and I can count on that.

Since I can count on it, I take that vacation, or I buy the refrigerator, or I buy a new car, or I make improvements in my house. The fact that people can count on money makes them feel better about the future so they spend, and that helps the whole economy grow.

So, I would urge making these tax cuts permanent because they remove a cloud of uncertainty over taxpayers, individual taxpayers, small businesses, and businesses, generally.

On FSC/ETI, the administration is clear. We want to see legislation that will put the United States in conformity with WTO by March 1, and we want to see it done in a way that continues to have American business competitive, that does nothing to prejudice the competitiveness of American business. I think the international tax regime is something that is, as you suggest, a burden on American business, that makes us less competitive.

It is a tax on our manufacturers, and getting change in that regime that you know goes back to the 1960's, a time when the United States was not much of a trading country. Those laws have not changed and we are heavily burdened, and I think prejudiced, by the current regime. So, I would certainly hope that, as part of the FSC/ETI and beyond, at some point we would address the inequities in the current global tax system.

Senator SMITH. Thank you, sir.

The CHAIRMAN. Thank you, Senator Smith.

I passed over Senator Bingaman, so I would go to Senator Bingaman. Then it looks like, of those who are here, it would be Mrs. Lincoln and Mr. Conrad, then Senator Santorum.

Senator Bingaman?

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

Mr. Secretary, thank you for being here. I have read through your statement. I am sorry I had to step out when you were giving the statement.

But I am puzzled about how you do not mention in there the Alternative Minimum Tax. At least, I did not see it anywhere in there.

I agree with you that people should know how to plan for their future, and that that is a good thing. To me, this is a threat. I mean, I picked up Business Week magazine last week. It says, "The Stealth Tax." This is the Alternative Minimum Tax they are talking about. It is going to apply to 30 or 40 million Americans by the end of this decade, or shortly thereafter, if we do not fix it.

Now, there is a constant drum beat from you, the President, and everybody else: make the tax cuts permanent, make the tax cuts permanent so people can plan, and there is not a word about how you are going to fix this problem.

There is nothing in your budget that fixes it, except for this year. You have got $23 billion in there for this year. But as far as the rest of this decade, we have to assume that you are not going to fix it. That is what your budget assumes.

What is your thinking here? Why do you not tell us how much it is going to cost to fix this, how you propose to fix it, and put it in your budget?

Secretary SNOW. Senator, the budget that has come up to the Congress indicates that the President has asked the Treasury Department to do a review of that subject and to be in a position to make recommendations, hopefully in time for next year's budget. We recognize this as a very serious problem. We also recognize it as a very complex problem.

Senator BINGAMAN. Should we not know the answer to that problem before we make a decision about locking in anything in the rest of the Tax Code?

Secretary SNOW. Senator, you ought to have that as soon as we have it. I am not, today, in a position to give you the sort of well-thought out, well-considered recommendation on this subject that you and the members of the Finance Committee deserve. I do commit that we will do our very best to have that sort of proposal for you next year.

The problem here, as you know, is the AMT is an alternative tax system that directly plays off the primary tax system and is integral to it. It is the byplay between the deductions in the major tax system that affect the alternative tax system.

Senator BINGAMAN. Right.

Secretary SNOW. And I think what we are talking about here is something, frankly, probably larger than simply a fix on the AMT. I think the fix will have to involve broader reforms of the tax system.

Senator BINGAMAN. But it just strikes me, as I understand the economics of it, if we take your advice and the President's advice and make these tax cuts permanent right now, that even makes the problem of the AMT worse. That adds to the number of people that will be subject to the AMT in the future.

So, you are setting us up to a situation where you are telling us, make this situation worse before we tell you how bad it is, which does not make a lot of sense to me.

Let me go on to another issue here. This is this section in your statement about, "Invest in Health Care." The administration proposal here, as I understand it, is that you want to have a credit for a tax credit, refundable tax credit to help the uninsured to buy insurance.

Yet, when you get into the budget detail here, you have got this little proviso that says, this includes contingent offsets that would cover the estimated increase in mandatory spending that would result from the proposal.

Now, that means this committee. You are saying that this committee should go find $65 billion in order that you can provide some kind of a tax credit on health care. Where do we find that? What is your recommendation there?

Secretary SNOW. Well, Senator, as we move down the path, I hope you will look hard at this proposal because it will help millions of people gain access to health care coverage, but it will cost. I think it has got a price tag of $65–70 billion. As you consider this, we would want to work with you to help identify what some offsets might be.

Senator BINGAMAN. My time is up, Mr. Chairman.

The CHAIRMAN. Thank you.

Now, Senator Lincoln. Then we will go to Senator Santorum, unless Senator Conrad comes back.

Senator LINCOLN. Thank you, Mr. Chairman.

Thank you, Mr. Secretary, for being with us today.

The President took a trip recently to the Ozarks last week. As you know, I represent a good part of that country, so I was paying attention to his visit. I have been listening to the committee talk an awful lot about small business folks.

When he was in Springfield, Missouri, I guess, the President said that most small business owners are sole proprietorships or subchapter S corporations, which means they pay the tax at the individual income tax rate. So when you hear us talking about cutting individual income tax, think about small business as well. This is what the President has alluded to, and you, yourself. I know there have been other questions. I am not real sure about this 80/80 thing that Senator Smith brings up.

I have a lot of small businesses in my State, and I come from a small business family. I asked my staff to look into this argument about marginal tax cuts and their effects on small businesses, because small businesses are our largest employers in Arkansas. What we want to do, is grow jobs. If this is our largest employer, we want to give them incentive and help to grow those jobs.

But if you take a look at this chart that we have come up with after the information we gained from the IRS, these IRS statistics, the overwhelming bulk of small business returns are reporting $50,000 or less in income. Nationwide, the number is around 62 percent.

In my home State of Arkansas, it is about 72 percent. In Missouri, where the President was speaking, it is over 65 percent of the small business that are reporting incomes of less than $50,000.

So, if you look at this chart and you look at where the majority of these small businesses are, they are not in the upper income brackets where you are talking about a great deal of this relief is going to be coming to them. Less than 4 percent, as a matter of fact, of the small businesses and the farm returns in America are bringing in $200,000 or more.

So, I really guess my first question is, I do not understand where you all are coming up with that this is such a great boost and a help to small businesses. And is there not really a more focused way of providing tax relief to America's small businesses than cutting these top tax rates or making these tax rates permanent?

I guess, from the Treasury's standpoint, if you have any information which would indicate how many of these returns above $200,000 that are in the top tax bracket, which kicks in around $319,000, I would certainly like that information if you have it available.

Secretary SNOW. Well, I have not seen this chart before. It is interesting. What I will do, is look at it and analyze it.

Senator LINCOLN. Well, these are IRS statistics.

Secretary SNOW. Yes. But you are asking me to comment on it, and I would like to think about it before I comment on it. I am trying to figure out how to reconcile the statistics we have with the statistics you have that indicate that the owners of these so-called flow-through entities—and I am not sure this includes all the flow-throughs, or some portion of the flow-throughs.

Senator LINCOLN. I am not sure. Are you talking about subchapter S? I mean, it includes small business subchapter S, and I think all of the flow-throughs you are referencing.

Secretary SNOW. Yes. All right. But owners of these flow-through entities, which comprise a lot of small business and entrepreneurs, comprise something like, oh, 65, 70 percent—maybe around 70—of the returns in the top bracket.

Senator LINCOLN. Well, that is not what this indicates. The information I have gotten from the IRS says that, nationally, 62 percent are below $50,000.

Secretary SNOW. Well, as I say, I think we need to reconcile your numbers with the numbers I am working with. I will undertake to do that.

Senator LINCOLN. Well, I would appreciate it if you could provide me some information.

Secretary SNOW. I will do that. We will do that.

Senator LINCOLN. I would also like to see if the Treasury has some data that they might share with us that shows how many of these small business owners earning below $50,000 are EITC recipients. You may not have that information handy. I do not know if any of your folks do.

Secretary SNOW. I do not have it at my fingertips, but we will certainly see.

Senator LINCOLN. Well, that would be an enormous help, so I hope you can provide me and the committee with that information.

Secretary SNOW. Yes. Right.

Senator LINCOLN. I have got a couple of other questions I would like to start on, and I may have to go to the second round. But last year the President proposed a budget which accelerated all of the 2001 tax cuts except for two, the marriage penalty on the EITC and the refundable portion of the child tax credit. You have heard me a lot on that issue.

Even though you left it out in that piece, we were successful in having it added to the 2003 bill in the committee. After it went to the conference committee, it was stripped out. As you know, the President signed the bill into law.

The Senate did quickly act, I think, with a voting of 94:2 to accelerate by 2 years the refundable portion of the child credit, and the House passed then an $82 billion bill, clearly intended to derail the bipartisan Senate effort that we had made.

The President did eventually get around to supporting that fix on the child credit. I have here, I think, the comment from the White House that says, "Pass it." His advice to the House Republicans is to pass the acceleration of the refundable portion of the child tax credit and send it to him so he can sign it. He wants to make certain that this does not get slowed down, bogged down.

I guess my question to you, Mr. Secretary, is if the President truly wanted to correct the omitted child credit, which means an awful lot to working families across this country who make less than $26,000 a year, because they are not eligible unless they are working and they have got children, and we want to help them be a part of reviving this economy and instilling value into their family life and the other things that are so important to the fabric of this Nation.

If he wanted to correct the omitted child credit for working families that were earning less than $27,000, why is it not included in the President's budget for this year?

The CHAIRMAN. Could you give a short answer so I could go to Senator Santorum?

Secretary SNOW. Yes, I will. I think, as the Senate and the House move towards making permanent the things he wants, I think he will be prepared to talk to you about that as well.

The CHAIRMAN. Before Senator Santorum, I want to make a comment about small business creating jobs, and whether that high marginal tax rate that is a penalty on small business, if we go back up to 39.6, is bad.

Through most of my life, even when I started farming, I was working at the Rath Packing Company for seven years. I was working at a hoist company for 1 year. I was working at a Waterloo Register Company, a sheet metal company, for 5 years.

And, quite frankly, nobody that has ever been poor has ever created a job for me. If you are going to create jobs, you have got to give incentive to the people that have the money to create the jobs. Why would you want to put a penalty on anybody that is creating a job in America?

Senator Santorum?

Senator SANTORUM. I would just like to chime in on that, Mr. Chairman. The chart that Senator Lincoln had showed that 80 percent of the small businesses have revenues of under $75,000. I do not know too many $75,000 businesses employing a whole lot of people, other than maybe the person who started the business.

Now, that is not to say they are not an inconsequential business, but they are not the big job creators. I would just say, a business that has $50,000 in net revenue is not creating a lot of good-paying jobs. Now, maybe you think someone who has a $50,000 business is creating a lot of good-paying jobs.

I would suggest that the ones that are creating the good-paying jobs that this committee talks about all the time are the 60 to 70 percent of the businesses that filed at the top rate.

The businesses that the Secretary was talking about filing at the top rate, it is not inconsistent with the chart that only 4 percent of those businesses are eligible.

That tells you that, of those 4 percent, they comprise 60 to 70 percent of the filers. They are the ones that are creating the jobs that you and I are very concerned about and want to have created. I am concerned about jobs, too. There is a bill on the floor of the U.S. Senate, the highway bill. Everybody talks about jobs. I would like to ask the Secretary a question about that.

Senator LINCOLN. Can I just point out what you were asking?

Senator SANTORUM. Yes. I am sorry. Go ahead.

Senator LINCOLN. This number is after expenses. They are only taxed after expenses, and wages are expenses, as well as many other issues that are in there. So when you are talking $50,000, you are talking about after expenses.

Senator SANTORUM. I appreciate that. Again, I would still say that those are not the businesses that are creating the jobs, the high-quality paying jobs that we are going to be looking for.

Obviously, if they are not making a lot of money, they are not going to be paying a lot in taxes, so it is hard to give tax cuts to people who are not making a lot of money. But that is another story.

Again, back to you, Mr. Secretary, about this highway bill. My concern is jobs. I understand a lot of people here are voting for this bill because it is supposed to create jobs. My concern is that this bill is way over budget.

I want to know from your perspective, because the President has been very clear about this, that if we pass a bill here in the U.S. Senate, and maybe even override the President's veto, and have a highway bill that is not paid for, that adds to the deficit, that uses money outside of the highway excise and gas tax stream to fund transportation, what message does that send to our economy?

What message does it send to our foreign trading partners? What message does it send to the stock market and the bond market? What impact on job creation is the fiscal irresponsibility of this Congress going to rake on our economy?

Secretary SNOW. Senator, thank you. The financial markets today have confidence in the United States and in our ability to manage our financial affairs. The best evidence of that is the fact we have the lowest interest rates in 40, 45 years. If the market did not feel that we were going to manage our fiscal affairs well, they would not credit us, as they do, with low interest rates.

But if we fail here to show real commitment to spending reductions, to meeting the President's target, I think we are going to suffer an erosion of that sort of confidence and invite the sort of world that Senator Baucus talked about at the beginning, which is a world I do not want to see.

I do think that the highway bill is a litmus test, in a way. It is talked about in those terms in the financial community: a litmus test of the ability of Congress and the administration to deal effectively with the deficit. I think there are many, many, many people in the financial community and beyond watching us to see what we do.

The President sent a strong message to the Congress, about the 256 and the principals. I think, to see a bill come out well above that number, would have a very, very, very corrosive effect on financial market confidence in all of us.

Senator SANTORUM. Can you give me something concrete that you think could occur as a result of the lack of confidence in the financial markets, maybe the value of the currency? I mean, can you tell me some things that could go on that could be detrimental to job creation?

Secretary SNOW. Sure. I am just back from a meeting of the G–7 finance ministers, the largest economies of the world. The question they wanted to know of me, and grilled me on, is are you serious about these deficits.

What they see hanging in the balance, is if we do not bring our deficit down, it is going to affect the relative exchange value of our currencies. That was what was most on their mind. They made that very, very clear to me. Of course, we also have hanging in the balance interest rates.

If the financial markets concluded that we are not deadly earnest about dealing with these numbers and bringing them down and getting them into a manageable proportion, they will begin exacting a price, and that is higher interest rates.

Those higher interest rates have the negative consequences of reducing economic undertaking, of reducing purchases of new houses, new housing construction, of borrowing, and of that entrepreneurship and creativity that lies at the heart of the economy.

So, it is absolutely essential that we maintain fiscal discipline in this country. I think the price we would pay in jobs and growth is very high if we do not.

Senator SANTORUM. Thank you.

The CHAIRMAN. Thank you, Senator Santorum.

Senator Conrad?

Senator CONRAD. Thank you, Mr. Chairman. Thank you, Senator Baucus.

Welcome, Mr. Secretary. It is always good to be with you.

I wanted to pick up on your points about job creation and a strong economy. I think we can just stipulate to the fact what you were saying earlier is exactly right. What creates jobs is a strong dynamic economy and support for entrepreneurial activity. Those are the key underpinnings.

But I think it misses the point about what is threatening a strong economy for the longer term, which, as I see it, is the growth of these deficits and debt, what you were just referencing.

When I look at where we are headed, if we properly account for everything that is being proposed by the administration—and I must say to you, when the President says he is going to cut the deficit in half over the next 5 years, I do not believe it.

I do not believe it, because the only way he accomplishes that, is he has left out huge categories of spending. But if we account for the President's tax cut proposals, the AMT reform, and the defense costs, this is what we see happening to the debt: it is skyrocketing.

Let us go to the next slide. If we look at one element of that, it is the President's proposals to make the tax cuts permanent. The President has a 5-year budget proposal, but you can see right past the dotted line which represents the fifth year, the cost of the tax cut, including the interest costs associated with it, explode.

Let us go to the next one. Financial Times ran this story, the IMF warning us about the combination. The headline says, "Tax Cuts," but they are talking more than just the tax cuts. The IMF is warning us about increased spending, in combination with the tax cuts, driving us over a fiscal cliff.

Let us go to the next, because this gets to the heart of the question about a strong economy. This is what the IMF is warning us. First, that sustained fiscal deficits lower national savings and will eventually raise real interest rates, both in the United States and abroad, thus crowding out private investment. The eventual cost will be lower global productivity and income growth.

Do you agree with that basic premise?

Secretary SNOW. Senator, deficits, if they are entrenched and rising and not managed properly, becoming a larger share of the GDP of the country, will have the effect of raising interest rates and crowding out private capital and hurting long-term growth. Absolutely. That is why it is so essential that we not allow this deficit to become entrenched, that we make it a declining share of GDP.

Senator CONRAD. But, Mr. Secretary, these deficits now are entrenched. That is exactly the point, these deficits that are at record levels now. When the President says he is going to reduce the deficit to $237 billion in the fifth year, he leaves out war costs, he leaves out fixing the Alternative Minimum Tax, which is turning from a millionaire's tax into a middle income tax increase.

He is leaving out the big ones, and he is taking in that year alone $259 billion from the Social Security trust fund, every penny of which he has got to pay back. All of that is being added to the debt. The truth is, the debt is not going to increase by $237 billion in that fifth year. The debt is going to increase by over $600 billion in that fifth year. Is that not true?

Secretary SNOW. Senator, you know those numbers in our own budget. We keep the debt down below 40 percent, around 40 percent. In 2009, it is 40 percent. The deficit is less than 2 percent.

Senator CONRAD. But, Mr. Secretary, let me just say to you, when you are saying below 40 percent, the thing that you are missing is that you are talking on a unified basis, when you jackpot all the funds.

What is fundamentally different this time, fundamentally different, in the 1980's, there was virtually no Social Security surplus to take. There was only $200 million of Social Security surplus in 1983. This year, the Social Security surplus is $160 billion. In the fifth year, the Social Security surplus, according to the administration, is $259 billion. Under the President's plan, you are going to take every penny of it to pay for other things.

The second point they make here, is that higher U.S. deficits means that Federal debt will not be brought down as had previously been envisioned, making the impact of an aging population on Social Security and health programs even more difficult to deal with.

These are, it seems to me, the fundamentals that threaten the very dynamic economy you are referencing that threaten long-term economic security. It is why I believe the President's plan is badly flawed.

We cannot, we simply cannot, when revenue is already the lowest it has been as a share of GDP since 1950, have a budget plan that raises spending and cuts revenue further without paying for it.

Secretary SNOW. Perhaps just a brief response. The receipts are unusually low. There are various things driving that that are unique and that abate as we go into the years ahead. You see the receipts going back up to about 18 percent, which is the historic level.

On the AMT, we have not put a number in there because I do not know what the fix is. But we will be working this year, and I look forward to sharing our thoughts with you and the members of the committee, on what that fix is. We would like to make it as revenue neutral as possible so it does not have the big effects that you are building into your numbers.

On Iraq and Afghanistan, we put them in supplementals because we do not expect them to be baked into the basic budget. So, those are in the nature of one-time expenditures rather than baked-in expenditures. So, I think it would be inappropriate to take those numbers and to run them out. But on your larger point, I——

Senator CONRAD. Can I just say to you, Mr. Secretary, with great respect—and I have great respect for you. I know that in the past when you were in the private sector there was no more vigorous spokesman on exactly the issues I am raising here than you were, and I applaud you for the positions you have taken in the past.

To construct a budget that leaves out any war costs past September 30 because we do not know what it is going to be, that is not credible. We know the right answer is not zero. That is what the President has.

On the Alternative Minimum Tax, we know the right answer is not zero. That is what is in the President's budget beyond this year, zero. We know that the Social Security trust funds are being taken to pay for other things. That money is going to have to be paid back, and not to acknowledge it is to mislead the American people and this Congress as to the depth of the problem we confront.

Secretary SNOW. The real size of this deficit, the real scope of this deficit, the real underlying problem we face, is not this fiscal deficit, if I can say it that way, because we will find a way to work our way through that. The big issue that is driving those out-year numbers is, of course, Social Security and Medicare, with Medicare being the huge driver of those numbers.

Somebody has said that destiny is demographics, and those demographics are about to hit us, which is why we need to find answers on Social Security, and even more importantly, answers on Medicare.

If we could grow Medicare, restrain to Medicare growth to GDP plus one rather than two, the changes in those curves going out is enormous. If you get Medicare to GDP level, you end up with a benign picture for the FSC of the United States going out there.

So I think, while we need to talk about these issues—and they are awfully important—over the next five years, the really critical thing is getting ready for those out years, where answers now have to be found if we are going to be able to heal those problems.

Senator CONRAD. But that is just the point. That is why saying, make the tax cuts permanent, when you have already got record deficits, you have got revenue at the lowest it has been since 1950, and when, in looking at the long-term, the 75-year cost of the President's tax cuts are three times the Social Security shortfall over 75 years, all these things are related. It seems to me, the first thing to do is quit digging the hole deeper.

The CHAIRMAN. I think it would be appropriate for the Chairman to take a few minutes, since you went over. Could I just make three quick points? I am trying to help you, Mr. Secretary.

Number one, when it comes to tax policy, it is legitimate to have this debate about tax policy. But if there is something wrong with the Republican tax policy that was adopted in 2001, it is only 5 percent more wrong than the Democrat tax policy the same year because their alternative was $1.2 trillion compared to the $1.35 trillion that we eventually adopted. That was their alternative.

Senator CONRAD. Mr. Chairman, would you yield for a point on that?

The CHAIRMAN. Yes, of course I will. That was 2001.

Senator CONRAD. But that is just not accurate. It is just not accurate to say that was the Democratic plan. The Democratic plan was the plan I put before our colleagues, which had half as much of a tax cut for the long-term.

In fact, it had more of a tax cut in the short-term, to give lift to the economy, half as much of a tax cut over the 10-year period to avoid this very problem. That was the Democratic plan.

At the end, one of our members offered an amendment that had less of a tax cut than you were proposing that was more fairly distributed. But that was not the budget plan of the Democrats.

The CHAIRMAN. Let me label it this way: a plan other than any Republican had wanted to cut taxes by $1.2 trillion, 5 percent less.

Number two, and this is an admonition to you because you get occasionally involved with the IMF, I would never use the IMF for an authority on anything. [Laughter.] Because every country they get involved in, they have got policies that ruin the middle class and bring political instability and social instability, and they do not end up helping the economy, mostly because of watering down everything.

This idea that you can be in a war and predict what a war is going to cost is just wrong. If, on December 8, 1941, FDR had to say what it was going to cost to defeat the axis powers, Hitler would have been in New York City. You only go to war to win a war, and you give the resources to the men and women, whatever it takes to win that war. That is not predictable way ahead of time.

Senator CONRAD. Mr. Chairman, might I just respond to you by saying this.

The CHAIRMAN. Of course you can.

Senator CONRAD. The right answer on the war cost is not zero. Goodness knows, we know that. The right answer is not, we are going to spend zero. We ought to budget what we think it is going to cost. The President, in 3 years, has had $250 billion of added spending above and beyond the budgets he submitted.

Now, come on. We can do better at budgeting than that. And certainly to say now there are no war costs past September 30, does anybody in this room believe that?

The CHAIRMAN. No.

Senator CONRAD. Well, then why do we not, instead of putting zero, put what we believe it is going to cost.

Secretary SNOW. Well, we would if we knew.

Senator CONRAD. Well, we know it is not zero. What you have got is zero. Is that what you believe?

Secretary SNOW. No.

The CHAIRMAN. If I do not say anything more, will you stop, too?

Senator CONRAD. Yes. [Laughter.]

The CHAIRMAN. Senator Baucus? I am going to go vote. Mr. Secretary, I think Senator Lincoln wants to come back and ask you a question.

Secretary SNOW. All right.

The CHAIRMAN. So, if you would wait just a little bit.

Secretary SNOW. Yes.

Senator BAUCUS. Mr. Secretary, I am not going to get into a sparring match here. I do not think that is very constructive or productive here. But I would like to just tell you—we do not have enough time to really sufficiently explore this—that I think it is important that the administration, working with the Congress and the private sector, business, and labor, start to fully address this question of offshore and outsourcing, because it is huge, and American competitiveness, generally.

I am personally going to spend a good bit of my time trying to figure out some answers, but I think this is a huge, major problem that the United States is now facing. I do not think America fully understands the degree to which this is a problem.

I think it is akin to the day we all woke up and we saw Sputnik. The Russians put Sputnik up there, and Americans asked ourselves, oh, my gosh. That happened? We were asleep at the switch.

I think the same is happening here today with respect to where our country stands economically with jobs, not only today, but in the future. That is, a vast number of engineers that are graduating in other countries, India exceeds that of the United States, computer science numbers, exceed that of the United States, to say nothing of other countries.

I do not think Americans realize that. We are going to wake up 1 day and it is not going to be quite like Sputnik, which is very visible, and find ourselves way behind the eight ball. It behooves us, as those who are elected and hold public office and have the public trust, to begin to mutually address that in a nonpartisan way, but in a very, very solid way.

I just urge you to take that to the President. You are looking at one Senator who very much wants to work with you in an honest way to get that done.

Secretary SNOW. Senator, I appreciate that. I will take up that challenge and make an appointment to come see you and see if we cannot work together to find some answers on this, because it is a serious issue. I would not downplay it for a second.

Senator BAUCUS. Yes. I appreciate that. I understand the Senator from Arkansas is returning here. Otherwise, you might as well get back to work. But Senator Lincoln is coming back. We will stand in recess until Senator Lincoln returns.

Secretary SNOW. All right. Thank you.

[Whereupon, at 3:40 p.m., the hearing was recessed to reconvene at 3:45 p.m.]

Senator LINCOLN. Mr. Secretary, I appreciate your indulgence.

Pursuant to my conversation with the Chairman on the train over from the vote, I will call the committee back into order.

I just had a few follow-up questions, particularly on the child credit, as well as one other question. I would just like to note, too, to my colleague from Pennsylvania, I am concerned about, I suppose, that he does not have a lot of confidence in our small businesses to help grow the economy.

I hope that is certainly not the impression of the administration. They are a huge part of the economy, and growing the jobs that we need to have. Again, I will point out that the $50,000 there is after expenses.

He also mentioned that they do not pay much in taxes. I guess I would remind my colleague that these small businesses may not be paying an awful lot in taxes, but there is certainly a lot of large employers who are NOLs right now, a net operating loss, situation and they do not pay taxes either. I guess you would know, certainly, as a former CEO at CSX, in a net operating situation, would they have paid taxes? No, they would not have.

Secretary SNOW. No.

Senator LINCOLN. That was a good many they employed there, but, still, they did not pay taxes, I would assume, in a net operating loss.

Secretary SNOW. Well, yes. If the net operating losses are larger than your earnings, then they offset the earnings and taxes are not paid.

Senator LINCOLN. Exactly. Well, I would just point that out. Again, I hope we will have a great deal of confidence in our small businesses across this country because they do employ a lot and they contribute a tremendous amount.

Secretary SNOW. Well, yes, I agree with you. They are absolutely vital. They are right at the center of this recovery we are having.

Senator LINCOLN. Right.

Just to jump back quickly to the child credit, the refundability of that. I hope, from the rhetoric that we have heard from the President there and the lack of the fact that these 12 million children across this country in working families are not receiving that credit, many of whom are in military families whose parents are serving abroad in Iraq in our armed forces, I think it is a critical place where we can make an enormous investment in the infrastructure and the fabric of our country.

I have heard the President's speeches call for making the existing child credit permanent. You mentioned that you would like to work to that end. Again, I would have hoped to have seen it in the President's budget if it was really a commitment from him.

But the remaining year of acceleration for the refundability of that child credit would cost about $1.75 billion. I would assume that the House would want to duplicate its effort from last year. I do not know; none of us can prejudge the House.

But they borrowed $82 billion to pay for a massive expansion of the credit for the wealthy families as a ransom for the working families that I was trying to help in the modest bill that we introduced.

At 3 percent interest, Mr. Secretary, the interest alone for the House's child credit permanence bill would be approximately $2.46 billion, almost $1 billion more than is needed to fix the problem for working and military families.

I guess my question is, is the House plan what the President is talking about in his speeches and on the talk shows in what he is going to do in remedying this, and should we be prepared to offset the costs of the President's proposal on that child credit, or if he is going to deal with it that way?

Secretary SNOW. Yes. What I know in terms of the President on this, is that he has said he would sign a bill, if the Congress sent it to him.

Senator LINCOLN. Well, if he is that adamant about it, I am surprised it is not in his budget this year.

Secretary SNOW. Well, I think if you send him a proposal on this, you will get his attention. Congress never sent him a bill on that score.

Senator LINCOLN. Well, my hope is that 12 million children would not need just the Congress to get his attention.

I guess one of the other things that I would point out, is that in some of the deficits that we are seeing, and certainly the circumstances that many of our States are finding themselves in in terms of strapped financial circumstances, they are seeing a need to raise taxes in our State, particularly sales tax.

These are taxes that hit heavily upon these families, these working families, when they do not get the benefit of the tax cuts that we present here in Washington, and yet they continue to see the increase in taxes in their everyday lives. Whether it is payroll taxes, whether it is sales tax, whether it is excise taxes, or whatever, they are getting crunched.

And as a working family that is making $27,000, I just have to re-impress upon you all that is a critical, critical group of individuals across this country who are working hard to maintain the fabric of our Nation, and I hope that you will give it real serious thought.

Secretary SNOW. Well, Senator, we are very sympathetic to what you say. The best way to tee that up for action, I think, would be to move the permanence provisions. Of course, the child credits are a part of what we are saying should be made permanent, and the marriage penalty, and the 10 percent, and so on, because they expire. So, there is a real, real need to act, and there is a vehicle for doing it that could encompass more of what you are talking about here.

Senator LINCOLN. Yes, sir. Well, we have heard an awful lot of that, and we still have these 12 million children that are out there and not getting a benefit that the rest of American families are getting. So, my hope is that we will act, and we will act in good faith on behalf of these working families in our country.

Just one last thing. The administration speaks quite a bit about cutting spending. You have talked a little bit about it today in order to reduce cost and the size of government. In fact, some would have you believe that if we just held down the growth of foreign aid, we would just about have everything under control.

This chart here, I think, indicates to all of us, is it not true, that we could eliminate the entire non-defense discretionary budget, the entire government, basically, and still be in deficits? We have got an enormous problem to get our arms around. We have heard a bit about the goals of the administration to cut the deficit in half in over 5 years. This concerns me.

I think that half is a thought, but it certainly should not be our goal. We should be looking at a stronger goal than just cutting it in half. I think even President Reagan claimed that he would try to balance the budget in his 5-year budget.

So, I guess, in looking at that, you are predicting in your budget documents a fairly consistent rate of growth of about 3 percent over the next decade. I guess, if that is the case and if the budget decisions that you advocate are supposed to create all of the growth that we are talking about, number one, why is it not reflected in the budget?

If it is a consistent 3 percent, why is there not a reflective growth in the budget? I guess, number two, why is it that we are not working towards a balanced budget?

Secretary SNOW. Well, the goal ought to be as close to convergence as you can get. I agree with you.

The budget of the President that he has submitted is a pragmatic document that recognizes the realities of the war on terror and the need for homeland security, and the need to keep the economy strong by sustaining the tax reductions and making them permanent. This is a tight, tight deficit.

If we had not had 9/11, we would have seen a whole different budget here. If we had not had al Qaeda and had not had the Taliban and had the Iraqi encounters, and so on, if we did not have this menace of world terror, we would have a very different, different budget. As the President said recently, he has found himself in the position of being a wartime President and of conducting——

Senator LINCOLN. But those costs are not reflected in the budget, are they?

Secretary SNOW. Oh, yes.

Senator LINCOLN. Iraq, and 9/11?

Secretary SNOW. Well, sure, because the defense budget is up 7 percent. The homeland security budget is up 10 percent. So, we have got that baked in. Of course, in the prior years we baked in much higher expenditure levels.

Senator LINCOLN. But the full impact of those costs are not reflected in the budget.

Secretary SNOW. Well, you are talking about the deficit and the size of the deficit, and they certainly are very much baked into the size of the deficit because they were expenditures in prior years that have added to the deficit itself.

Senator LINCOLN. Well, I thank you, Mr. Secretary. I appreciate that. I am still a little confused why the growth that is talked about so much in this budget is not reflected in the budget.

Secretary SNOW. With these charts of yours, Senator Lincoln, you may replace Senator Conrad as the person most noted for charts.

Senator LINCOLN. No, no, no.

I see the Chairman is back. I will hand it over to him. I appreciate you coming. But I would like to just reiterate how important I think it is that working families in this country get a fair shake at trying to help to grow this economy.

Those 12 million children that are out there, particularly those that belong to military families, if they are not a priority enough for this administration to put into their budget, I hope that they will be a priority enough that you all with hopefully begin to look at the prospects of what can be done.

They truly are out there working hard to make this Nation great, and I feel like it is so important that we do all that we can to assist them in raising those families and giving back to this country. I hope it will be reflected in something you do, even if it is not in this budget. Thank you.

Secretary SNOW. Well, Senator, I thank you for that. And, as I say, I think the best way we can join that issue is by moving forward on making the tax cuts permanent. Of course, if we do not, the accelerated child refund, the 10 percent, the marriage penalty, all of those are put in jeopardy.

Senator LINCOLN. They have not had theirs yet, their refundability. Thank you.

The CHAIRMAN. Thank you, Senator Lincoln.

I have a question on one subject. Before I ask that question—and then I think we will probably be adjourning—on the floor just now, Senator Kyl said he would not be able to come. He is going to submit three questions for a response in writing. Senator Snowe was here and she has got a vote in Intelligence and will not be able to come. I think she indicated she might have some questions. And maybe everybody that could not come might have some questions, including those of us who are here. So, we would appreciate a response in writing.

Secretary SNOW. We would be pleased to do that, Senator.

[The questions appear in the appendix.]

The CHAIRMAN. Yes. I would like to talk to you about an item that you have heard me comment on, and we have even talked about on the phone, and that was the war on terror financing.

First, I am worried that all of these changes we have made in the government in the past 2 years have not really helped us stop the funding of terrorism. There is a question about who should be chairing the Senior Interagency Meeting on Terror Finance.

There have been some other turf battles on terror financing crimes. I think Treasury has been short-changed, and we are going to look at bringing some enforcement resources back to Treasury.

Second, I am also concerned about our targets in the war on terror financing. We have gotten a lot of low-hanging fruit, like users and transmitters of this blood money, but it is not clear we have made a dent against foreign donors, people with deep pockets who sustained terrorism.

So, I would like to hear what we can do to get other countries to go after those donors, help us more, whether we have to use a carrot or a stick. So, address topics like the resources Treasury needs and the role it plays, and also foreign countries and terrorism donors operating in the midst.

Secretary SNOW. Mr. Chairman, thank you very much. You and I have talked about this before. Treasury is in the forefront of the battle, the war, the struggle against the blood money, the flows of the terrorist monies which make possible their heinous and wretched deeds. By interdicting those flows, we make it much more difficult for them to carry on their awful activities.

Treasury will be strengthened in its ability to do that because of some actions of the Congress recently in setting up a new assistant secretary for Intelligence, for financial intelligence, which will give us, for the first time, our own resources to deal with the financial intelligence gathering, which is a critical component of this.

The legislation also contemplates some restructuring of the entire set of activities within the Department, which would strengthen our hand. The Department is moving forward to try and implement those ideas. I hope to have that new organization up and running soon.

It will be a focal point for all terrorist financing activities within the Department and will give us one central focal point for those activities that will be our representative in the intergovernmental policy councils and will create a stronger structure within the Department to focus on these issues.

On the international front, I do think we have made an extraordinary amount of progress. This FATF, this Financial Action Task Force against terrorists now has most of the civilized nations of the world engaged in it. At the G–7 meeting that I referenced earlier that we just came back from, the finance ministers each talked about the initiatives in their countries. There is a global commonality here to go after the terrorists. There is a sharing of best practices. There is a continuous upgrading of the financial institutions to be able to trace and track terrorist activities and terrorist money activities.

What we have found, Mr. Chairman—and this is fascinating—is that as we have gotten the financial institutions of the world better attuned and better equipped to deal with the terrorist menace, the menace of terrorist financings, the terrorists have been changing their modus operandi, moving more and more out of the formal financial system and more and more into a network of informal money flows, through couriers and through organizations called hawallas that manage to transport money around the world.

We have now gotten consensus among many, many countries of the world that they need to be equally vigilant in this informal network. We have worked with many of the Middle East countries to interdict the flow of money to charities that is really money that is used for terrorist activities.

The Saudis, on this score, have been very, very forward-reaching and are now making it much more difficult for charities to be abused by terrorists, to send money through charitable organizations.

Just last week, week before last, we designated four branches of the major Saudi charity with the Saudi government itself, interdicting the flow of funds to that, blocking their assets. So, there is an extraordinary global effort on this.

But do we need to do more, and do we need to be vigilant, and do we need to continue to get better at this? Absolutely. I take your question in the spirit you gave it, that we can never rest on this.

The CHAIRMAN. I thank you very much for your response. I thank you for your appearance today, making up for the time when we had to cancel because of the ricin a week ago. I look forward to our continued communication.

I think I will shortly have some good news for you on Mr. Bodman.

Secretary SNOW. Wonderful. Thank you.

The CHAIRMAN. Thank you.

Secretary SNOW. That is great news. Thank you, Mr. Chairman.

The CHAIRMAN. The hearing is adjourned.

[Whereupon, at 4:02 p.m., the hearing was concluded.]

APPENDIX

Additional Material Submitted for the Record

Prepared Statement of Hon. Max Baucus

I am pleased to join in welcoming U. S. Treasury Secretary Snow to address the president's budget. I support a number of proposals in the president's budget. I am heartened that the administration has acknowledged that we need to do something about the deficit, but I am concerned that a plan to balance the budget is notably absent from the president's budget.

This budget is fiscally unsound. It will leave us with a $521 billion deficit for this year. This is almost $150 billion more than the previous record deficit—set just last year. But of even greater concern are the continuing deficits proposed for the years ahead. These deficits will raise interest rates, slow economic growth, and leave Americans poorer. Just for one example, a recent Brookings Institution study projected that continuing to run deficits of 3 percent of the economy would raise mortgage interest rates by a full percentage point. Continuing deficits would thus increase the annual payments on a typical mortgage by about $2,000 a year. That's the equivalent of a $2,000-a-year tax increase on American homeowners.

The federal government's finances work something like those of a household that borrows money from a bank. If the household borrows more and more money from the bank, at some point, the bank will refuse to lend any more money, because the bank will be concerned that the household will not pay the money back.

The same can be true for a country. It can continue to borrow money from both domestic and foreign sources. But at some point, some lenders—especially foreign lenders—will begin to worry about whether the U.S. will pay all that debt back. At some point, these lenders may stop lending as much to the U.S., or demand a much high interest rate in exchange for lending to the U.S.

These higher interest rates will slow business investment, and that will slow growth. And slower growth will mean fewer and less-well-paying jobs. American people will be poorer, because of these deficits. Yes, this budget presents deficit projections for the next 5 years—through 2009—that trend down to $237 billion. But there are several reasons why these projections are unlikely to hold true.

First, these projections leave out any proposals to fix the Alternative Minimum Tax—or AMT—beyond a short-term fix. Under current law, about 27 million tax filers would have their taxes raised by the AMT in 2009. No one believes that the president and Congress will let thathappen. To fix this problem in fiscal year 2009 would cost $58 billion in that year alone. But the president's budget does not include that funding.

Second, the president's estimate of the 2009 deficit allows total discretionary spending to increase by only 4 percent a year. This is unrealistic, given expected and needed growth in military spending and homeland security for many years in the future. Allowing total discretionary spending to grow by even 5 percent a year would add approximately $50 billion to the budget deficit for 2009.

If we plan for the AMT and increased discretionary spending, we would see a deficit in 2009 of approximately $350 billion, more than $100 billion above the administration's prediction. This is almost three-quarters of the deficit in 2004, not half, as the president promised. Even as a share of the economy, it would account for 2.4 percent of GDP, still larger than the half that the president promised.

But of much greater importance, running a 2009 deficit of $350 billion is reckless, when the baby boom generation will begin to retire in 2008, just 4 years from now. To cope with the pressures from the baby boom's retirement, we need to put the government on a glide path to a balanced budget. That would be fiscally responsible.

But rather than propose a balanced budget for 2009, the president's budget proposes a deficit of $237 billion, which translates to $350 billion with the adjustments necessary to reflect what will more likely happen. And the budget's glide path in 2009 is going in the wrong direction. Using CBO numbers and adjustments similar to those I made for 2009, the president's proposed deficit for 2014 rises to $530 billion—3 percent of GDP. It is moving in the wrong direction.

One of the reasons that the president's budget would lead to a $530 billion deficit in 2014 is that the administration wants the Congress to make all of the 2001 and 2003 tax cuts permanent. It would be more responsible to wait to make decisions about the permanence of these tax cuts until we know the state of the economy when these tax cuts are closer to expiring. In addition, when the economy is this deep in the red, we should ensure that any additional spending and tax cuts are paid for. I encourage the president to take another look at our deficit before pushing for an unpaid, permanent extension of the tax cuts.

In addition to making the tax cuts permanent, the president has also proposed programs that will significantly add to the deficit and not directly aid our economy. The administration proposes to put people on Mars and an outpost on the moon. This will cost hundreds of billions of dollars—hundreds of billions of dollars that we do not have.

In addition, the president—in his State of the Union address—proposed the partial privatization of Social Security. Any such proposal would likely keep in the current Social Security system all workers who are age 55 or older. There would thus be huge "transition costs" to the federal government over the next several decades to maintain the benefits for those beneficiaries who are still in the current system. The "Economic Report of the President" released this week verifies the magnitude of these "transition costs." By the year 2041, these costs would require an increase in the Federal debt held by the public of $4.7 trillion—in today's dollars. That's an increase that would be larger than the entire $4.1 trillion of debt held by the public today.

And the budget includes a proposal to create new Lifetime Savings Accounts and Retirement Savings Accounts for individuals. While this proposal would have small budgetary costs between now and 2014, it would have continually increasing costs beyond that year. One estimate puts the annual cost in 2030 at $30 billion—one-half a percent of GDP.

Faced with the retirement of the baby boom generation, these three proposals alone show a surprising lack of fiscal discipline. In contrast, when previous administrations of both parties were faced with high deficits, they made it a priority to reduce them. They may not always have succeeded, but they tried. This administration seems to have simply thrown in the towel.

I am also very concerned that this budget does little to help those who need it most. For example, the budget proposes tax cuts that are supposed to help low- and moderate-income individuals who have no health insurance from their employers. Unfortunately, this proposal would likely leave people to face the costly individual insurance market without providing them with sufficient assistance to purchase the coverage that they need. Moreover, the tax cuts would subsidize the individual insurance market even though it tends to provide insurance to only the young and the healthy.

At the same time, this budget does little for workers who do not have jobs. In particular, it does not provide tax relief to the manufacturing industry, which has lost jobs for 42 straight months now. In contrast, Senator Grassley and I have aggressively pushed a domestic manufacturing tax package that has passed the Finance Committee and is headed to the floor.

The budget also does not provide enough money for constructing new highways, even though highway construction creates jobs. For every billion dollars that goes into the highway program, 47,500 jobs are created. Yet the president's budget provides for only $201 billion over 6 years for new highway construction, whereas the Finance Committee reported a bill that provides for $255 billion over that period.

And so, I have serious concerns with the administration's budget. I want to see more fiscal discipline, and more dedication of funding to grow our economy and strengthen health care for all Americans. That being said, I have proved time and again that I am a strong believer in working together. That is the only way to reach our goals. I look forward to hearing Secretary Snow's thoughts about my concerns and his ideas on how we can work together.

PREPARED STATEMENT OF HON. JIM BUNNING

Thank you, Mr. Chairman.

Welcome to the Committee today Secretary Snow. I look forward to a meaningful discussion of the tax provisions contained in the president's budget proposal.

As I have reviewed the many revenue proposals released last week, I have been pleased to see the attention paid by the Administration to so many important areas—making health care more affordable, simplifying the tax laws, encouraging savings, as well as extending many expiring provisions. I was particularly pleased to see that a number of proposals to encourage charitable giving—ones that I have long championed—once again found their way into the President's proposal. Many, if not most of these important provisions, are part of the CARE Act that we passed on the floor of the U.S. Senate by a 95–5 vote in April of last year. For almost one full year, we have been unable to conference that bill with the House of Representatives and send it to the President. That fact is disgraceful and the members of this Committee should all commit to seeing that bill signed into law.

I suspect that a popular topic today will be the savings plans that were proposed in this year's budget as well as the prior budget proposal. The concept of simplification of retirement savings plans is intriguing and I look forward to learning more about those proposals and the benefits that the Administration feels they will bring to the savings of Americans.

Thank you.

PREPARED STATEMENT OF HON. CHARLES E. GRASSLEY

Good afternoon. I call this hearing to order. Today, we will hear testimony on the revenue proposals in President George W. Bush's fourth budget. That budget covers fiscal year 2005. The witness will be Treasury Secretary John Snow. Secretary Snow, welcome back to the Finance Committee. Mr. Secretary, Senator Baucus, and members of the committee, we find ourselves with a great many challenges. The American people expect us to take these challenges seriously, and I am confident that we will respond constructively.

The Finance Committee faces several major challenges this year. Foremost among those challenges, we will need to respond to the WTO ruling against the Foreign Sales Corporation replacement regime known as "ETI." In addition, we hope to address welfare reform and additional trade agreements. On the two principal tasks, the Finance Committee has taken the first step. Last fall, we reported the FSC/ETI replacement legislation and welfare reform. The FSC/ETI replacement regime came out of this committee on an overwhelmingly bipartisan vote: 19–2. We have the momentum and seek floor time from my friend, the Majority Leader. As the Secretary well knows, we face the very real threat of sanctions from the European Union on March 1st. Even in leap year, with the extra day in this month, we're talking about a little more than two weeks away.

We have to take the sanctions threat seriously. There are rumors that some in the other body poo poo this threat, saying that the phased-in schedule is no big deal. Well, let me be clear. I want clear sailing for expanding trade. This gambling with sanctions, if true, will bring a stormy environment to our efforts to expand trade. Gambling with sanctions is tantamount to playing with fire.

So, first off, Mr. Secretary, I hope you can assure me that the Administration agrees that we need to move the FSC/ETI replacement legislation quickly. On welfare reform, likewise, I hope to get some floor time to move the bill through the Senate. Its time has come.

We also haven't finished the job on tax relief for America's workers, families, and small business folks. Under the 2001 and 2003 tax relief bills, there is a sunset on tax relief. It is only fair to make this tax relief seamless and permanent. I don't think anyone wants to see a middle-income family of four see their taxes rise by at least $600 next year. That's what will happen if we don't extend the child tax credit increase and other family tax relief provisions.

Now, we have to tackle tasks at hand with rising deficits. Like most any Iowan, I get nervous when I see red ink. Over the long-term, the Federal government, just like any Iowa family, has to learn to live within its means.

There are some differences in how we achieve the objective of deficit reduction. One thing I'd like to do today is set the record straight on recent changes in revenues and spending. Contrary to what one often reads and hears, revenues are projected to stay at or near historical averages. The spending side of the ledger, however, has ballooned. I'm looking forward to hearing you, Mr. Secretary, outline how the Administration plans to get us back on a path of deficit reduction.

Before we finish this legislative session, Mr. Secretary, I hope that we will have enacted into law pension reforms aimed at the excesses of Enron and WorldCom. I also hope that we can put into law the tax relief portion of the President's faith-based initiative. As we move into this legislative session, I want to emphasize that we should pursue these issues, where possible, in unity. As the presidential campaign heats up, many seem to have the impulse to divide workers from business owners, and consumers from investors. But these are complementary activities; you can't have one without the other. We can't ignore consumers and workers, who have kept the economy going. In the same manner, we can't ignore business owners and investors, who create jobs and provide the capital for higher economic growth.

The Finance Committee will keep an eye on using the people's tax dollar wisely. We will have to operate within the confines of the budget resolution that Chairman Nickles will produce. On that score, Finance is the only committee in Congress producing significant offsets. If there is good tax policy, like curtailing tax shelters, and it produces revenue, I will pursue it. I'm pleased Mr. Secretary, for instance, to see the Treasury Department join us in shutting down the municipal sale-leaseback scams.

As is always the case, I anticipate the bipartisan cooperation that is the tradition of this fine committee. The American people expect us to focus on their problems and not on our own political agendas. I look forward to Secretary Snow's presentation of the revenue proposals in the President's budget.

PREPARED STATEMENT OF HON. JOHN D. ROCKEFELLER, IV

Mr. Secretary, thank you very much for coming to speak with us today about the President's budget proposal for the next fiscal year. I hope that our discussion today can help me understand the President's decision making process with respect to this budget, because to be honest I am quite concerned that, in general, the proposed budget does not reflect the needs of my constituents in West Virginia or families nationwide. I will not take a lot of time making remarks this morning, but I would like to outline just a few of the concerns that I have with the President's budget.

This budget does not do enough to address the most pressing need facing many Americans which is the need to find work. And the President's theory that shipping jobs overseas is really better for our economy in the long run is very cold comfort for Americans looking for work now.

Rather than focusing on job creation, the President's budget again focuses on tax cuts. I am eager to work with the President to find a way to extend the tax relief that has been provided to working Americans, in particular the child tax credit, marriage penalty relief, and expansion of the lowest tax bracket. But I am concerned that these priorities have again been drowned out by the President's insistence on additional tax cuts for wealthy Americans. Tax cuts for dividends and capital gains, for example, do not benefit most West Virginians and do not create jobs. So I will have to be very skeptical of efforts to extend those cuts.

Job creation, economic development, access to affordable health care, quality child care, saving for retirement, sending their children to college: these are the priorities that are on the minds of West Virginians. And I am concerned that too many of these priorities are shortchanged in the President's budget. As the budget process unfolds this year, I will be guided by these and the other needs of West Virginians, rather than the desire to provide additional tax cuts for the most fortunate in our society.

I would also like to say a few words about the deficit. The President has decided to make it his goal to cut the deficit in half over the next five years. By using very optimistic economic assumptions and some very unrealistic budget gimmicks, his budget allegedly achieves this goal. Rather than budget gimmicks, we need an economic policy that works for America—that creates jobs and truly deals with the deficit. Even half of the current deficit would be a staggering burden to impose on our children and grandchildren. And so I believe that this Congress must make some very difficult choices and must restore some fiscal sanity to our budget. I hope that the President will join this effort.

Again, Mr. Secretary, I thank you for appearing here today. I look forward to a vigorous and informative debate.

PREPARED STATEMENT OF HON. JOHN W. SNOW

Thank you, Mr. Chairman.

Thank you all for having me here today to talk about the President's budget.

I believe you'll find that this budget reflects the priorities of our nation as well as the leadership of President George W. Bush.

The over-riding theme of the budget, and the President's plan for the future, is that a safer world is a more prosperous world. That's why I'll be discussing both national and economic security here today.

Decisions about how to collect and spend taxpayer dollars—for this is what a budget is—must be made with both caution and vision.

The Fiscal Year 2005 budget proposal is, therefore, a plan that does three core things:

- One: Keeps Americans safe by providing the resources necessary to win the war on terror and protect our homeland;
- Two: Increases the economic security of our citizens as well, by strengthening our economy; and
- Three: Exercises the kind of spending discipline that is required by a government that respects the source of its money (hard-working taxpayers!) and is unwilling to live with a deficit.

Discussions of our budget and our economy are not, and should not, be separate. The two are inextricably connected.

Today, our economy is doing better.

Homeownership is up, unemployment is heading down, and GDP growth has been strong.

This administration came to office when those indicators were not nearly as positive.

The President inherited an economy that was in decline. . . one that was then battered by terrorist attacks and revelations of corporate corruption dating back to the 1990s.

The President and his administration took these challenges seriously and we have made *serious progress* in changing the economic direction of this country.

The President's tax cuts—passed by you—have worked. They provided the stimulus that was necessary to turn the economic ship around. . . and they are now encouraging and allowing for the economic growth that is continuing into the future.

- Economic growth in the second half of 2003 was the fastest since 1984;
- New home construction was the highest in almost 20 years;
- Homeownership levels are at historic highs;
- Manufacturing activity is increasing;
- Inflation and interest rates are low;
- Over 360,000 jobs have been created in the past five months;
- Unemployment claims—both initial claims and continuing claims—are well off their peaks last year, indicating improvement in the labor market;
- This Wednesday, the Dow closed at a 32-month-high. This translates into more than three trillion dollars of growth in value in the markets.

These economic indicators all point to the same conclusion: economic growth is robust and will be sustained.

However, there is more to do. We are not, by any means, satisfied.

There are still Americans who want to find work and cannot. . . and this Administration will not rest until that most critical need is met and until every American looking for work can find a job.

Our budget addresses that need by continuing to focus on improving our economy.

For example, the President's Jobs for the 21st Century plan, announced in his State of the Union Address, directs the resources of several branches of government toward matching skills with jobs, and helping workers acquire the skills they need to qualify for the jobs in their community.

We can also encourage the creation of jobs by sticking to the President's six-point plan for growth.

That includes making health care more affordable and costs more predictable.

We can do this by passing Association Health Plan legislation that would allow small businesses to pool together to purchase health coverage for workers at lower rates.

We also need to promote and expand the advantages of using health savings accounts . . . how they can give workers more control over their health insurance and costs.

And we've got to reduce frivolous and excessive lawsuits against doctors and hospitals. Baseless lawsuits, driven by lottery-minded attorneys, drive up health insurance costs for workers and businesses.

The need to reduce the lawsuit burden on our economy stretches beyond the area of health care. That's why President Bush has proposed, and the House has approved, measures that would allow more class action and mass tort lawsuits to be moved into Federal court—so that trial lawyers will have a harder time shopping for a favorable court.

These steps are the second key part of the President's pro jobs, pro-growth plan.

Ensuring an affordable, reliable energy supply is a third part.

We must enact comprehensive national energy legislation to upgrade the Nation's electrical grid, promote energy efficiency, increase domestic energy production, and provide enhanced conservation efforts, all while protecting the environment.

Again, we need Congressional action: we ask that you pass legislation based on the President's energy plan.

Streamlining regulations and reporting requirements are another critical reform element that benefit *small* businesses, who represent the majority of new job creation: three out of every four net new jobs come from the small-business sector! Let's give them a break wherever we can so they're free to do what they do best: create those jobs.

Opening new markets for American products is another necessary step toward job creation. That's why President Bush recently signed into law new free trade agreements with Chile and Singapore that will enable U.S. companies to compete on a level playing field in these markets for the first time—and he will continue to work to open new markets for American products and services.

Finally, we've got to enable families and businesses to plan for the future with confidence.

That means making the President's tax relief permanent.

Rate reductions, the increase in the child tax credit and the new incentives for small-business investment—these will all expire in a few years. The accelerated rate reductions that took effect in 2003 will expire at the end of this year. Expiration dates are not acceptable—we want permanent relief.

The ability of American families and businesses to make financial decisions with confidence determines the future of our economy. And without permanent relief, incentives upon which they can count, we risk losing the momentum of the recovery and growth that we have experienced in recent months.

The tax relief is the key stimulus for increased capital formation, entrepreneurship and investment that cause true economic growth.

Budgets work better when the economy is growing . . . because a growing economy means more jobs. That means more tax revenue . . . which leads to all-important deficit reduction.

Which leads me to my next area of discussion.

Let me be clear on this:

- The budget deficit that we face today is unwelcome.
- It needs to be addressed.
- The President's budget calls for cutting the deficit in half over the next five years.

While addressing the deficit, we must remember that it is not *historically* overwhelming.

- It is *understandable*, given the extraordinary circumstances of recent history. Remember that we are fighting a type of war that we have never fought before. We are fighting an enemy that requires a much broader variety of government resources than anything we've ever confronted. And we began this fight when we were economically wounded.

What's most important to remember is that *we will be able to fight this war and climb out of the deficit.*

We can *manage* this deficit, and we can cut it in half over the next five years by *controlling spending and growing our economy.*

Three-quarters of the discretionary spending increases during this Administration have been related to the global war on terror and the response to 9/11.

Meanwhile, President Bush has reduced the rate of increase in non-security-related discretionary spending every year he has been in office: to six percent in 2002, five percent in 2003, and to four percent in the current fiscal year.

For Fiscal Year 2005 we're going to reduce the rate of increase in non-security discretionary spending to less than one percent.

Total annual appropriated discretionary spending will increase by less than four percent next year.

Holding the line on spending—while ensuring that our country is safe and our most important needs, from jobs to health care, are met—will achieve deficit reduction when coupled with all-important economic growth.

Again, this is why the budget cannot be discussed separately from the economy. Separating the two is what gets government into trouble.

Make no mistake; President Bush is serious about the deficit.

We see it as unwelcome, but manageable . . . and we intend to achieve: *rapid deficit reduction.*

A recent CBO report raised concerns about this matter, and it is important to note that recent and short-term projected budget deficits and the existence of long-term deficits for Social Security and Medicare are *not connected.*

These unfunded long-term net obligations are also a concern, and ones that this Administration has highlighted and invited bipartisan dialogue on.

The President has been clear on this: younger workers should have the opportunity to build a nest egg by saving part of their Social Security taxes in personal retirement accounts. His vision for the program is economically wise, and it is that we should make the Social Security system a *source of ownership* for the American people.

Are we dedicating ourselves to increased spending on the war on terror and protecting the homeland? The answer is yes. Yes, without sacrificing other necessities.

And that is because a nation must be safe in order for it to be prosperous.

A nation of entrepreneurs must also be able to plan, and to be relieved of as many burdens as possible, in order to be prosperous.

All of the budget issues and policy proposals that I've discussed today may seem, at times, to be a complicated recipe. But these ingredients combine to make something that is simply put, and is of utmost importance—and that is *economic growth.*

Growth is the key to every economic problem we confront. That's why we urge other countries to institute pro-growth policies. It's good for them, and it's good for the global economy that we are a significant part of

Thank you for hearing my testimony today. I'll be happy to take your questions now.

Responses to Questions From Senator Bunning

Question 1. I noticed that the White House budget proposal includes $83 million for a new regulatory agency to oversee certain GSEs. I have spoken with your staff in the past about regulation of GSEs. Assistant Secretary Abernathy stated before the Banking Committee that he believes that the Tennessee Valley Authority should be under SEC jurisdiction—and I have video tape if you want to see it. Do you think that all GSEs, including non-housing GSEs, should be regulated?

Answer. The GSEs are privately owned but federally-chartered companies, created by Congress to facilitate the flow of credit into certain segments of the economy. The Administration's position that the GSEs should voluntarily register with the SEC under the Securities Exchange Act of 1934 is based on the principle that privately owned companies that offer securities to the investing public should be subject to greater market discipline and the full disclosure of financial information to enhance that market discipline.

The Tennessee Valley Authority (TVA) is, however, a government-owned corporation, wholly owned by the U.S. Government. As a wholly-owned government corporation, the TVA's spending and collections are included in the Federal budget, and TVA's borrowing authority is treated as budget authority. Also, unlike the GSEs, the TVA's borrowing authority is explicitly limited by statute. While the TVA is thus legally and institutionally different from GSEs, it does share one important characteristic—by statute, the debt obligations of the TVA are not guaranteed by the full faith and credit of the U.S. Government. This commonality has led financial market participants often to include TVA's debt obligations with the debt obligations of the GSEs in what is commonly referred to as the "Agency Securities Market."

In noting the differences between GSEs and government-owned corporations, we are not implying that wholly-owned government corporations should not be subject to any standards of operation and review. (For example, the TVA is subject to the Government Corporation Control Act and the Government Performance Results Act.) While the Administration position regarding GSE registration under the Securities Exchange Act of 1934 did not extend to government-owned corporations like the TVA, the Administration is open to further consideration of what form of public disclosures are most appropriate for the TVA.

Question 2. Recent numbers released by the Bureau of Labor Statistics from its comprehensive "household survey" for December 2003 reflect an employment increase of 1 million since January 2003 and 2.2 million since the declared end of the recession in November 2001. These numbers vary from those reflected in the "establishment survey" which has indicated that job growth is not as strong as the household survey would suggest. Alan Greenspan said this week that he believes that the Labor Department's establishment survey is superior to its household survey. As most of my colleagues know, I rarely agree with Mr. Greenspan on any issue, so I have doubts about his conclusion on the relative merits of the two surveys.

Could you please comment on the two surveys? Particularly, what do you feel are the strengths and weaknesses of each survey and if you have an opinion as to which one is a better reflection of what is going on in the U.S. economy.

Answer. The household survey (also known as the Current Population Survey) is based on interviews with about 60,000 households and provides information on approximately 112,000 persons 16 years and older. Employment in the household survey represents the number of people who are employed. It includes nonfarm wage and salary workers, agricultural workers, unpaid family workers, domestic help, the self-employed and those who are on temporary unpaid absences from their work. The strength of this survey is the demographic information that it makes available, such as unemployment rates by gender, race, and age. Because it is a sample, however, the estimates of national employment and other aggregates provided each month depend on estimates of the total population and its components. When the population estimates change, so do the estimates of major employment indicators from the household survey.

The payroll survey (also called Current Employment Statistics) measures the number of jobs and only includes nonfarm wage and salary workers who are on business payrolls. It is based on a survey of 400,000 individual worksites covering nearly one-third of nonfarm payroll jobs each month. Some workers hold multiple jobs or switch jobs within a pay period and may show up on payrolls more than once. This could artificially inflate the payroll results when the labor market is strong and artificially depress payroll growth when the economy is recovering. The difference between the household and payroll surveys widened by about 2.7 million between January 2002 and February 2004. Increases in self-employment—in the household survey but not counted in the payroll survey—account for about a third of the increased gap.

Each survey has strengths and weaknesses. The payroll survey is a larger sample and less volatile from month to month. However, the payroll survey ignores self-employment and may understate job growth at new firms during the early stages of economic recoveries. The household survey includes self-employment and may more rapidly incorporate job growth at new firms at this stage of the business cycle, although it is volatile from month to month.

Question 3. I was pleased with your Department's recently announced crackdown on travel agencies that are arranging trips to Cuba for Americans. I want to take the opportunity to commend the administration for the strong stance being taken on this very important issue. I hope my colleagues realize the wisdom of the Administration's position.

Travel will never bring freedom to Cuba. In fact, the opposite is true. The foreign currency spent by tourists in Cuba does not reach the Cuban people who are suffering as we speak. It goes into the coffers of Castro and helps him to prop up his brutal dictatorship. Can you comment on the engagement of Canada, the European Union and other countries with Cuba? What positive impact, if any, has the U.S. Government observed in Cuba in the last few years that can be attributed to this engagement? Do you anticipate that the engagement of the U.S. with Cuba would have an impact that would be any different?

Answer. There has been no change in the economic or political environment in Cuba as a result of Canadian or European tourism in Cuba or Canadian or European joint economic ventures in the island. Cuba's Armed Forces Ministry runs the state-owned and joint venture resorts. Tourist money that it receives only allows for the continuation of Cuba's repressive apparatus. Unrestricted U.S. travel to Cuba will do little to promote democratic change and much to bolster the regime by providing it with scarce hard currency. As the President has indicated, we will not consider lifting of sanctions absent significant political and economic reforms in the island.

Question 4. I recently heard a statistic that approximately 80 percent of the new jobs in this country are created by small business. I also understand that the majority of these small businesses—of S corporations or sole proprietorships—pay taxes at the highest individual rate.

One number I heard was that 80 percent of the taxpayers in that top bracket are small businessmen and women. We recently reduced this top bracket to 35 percent—the same as the top corporate tax rate. Can you comment on what you think the impact on the job creation capacity of this economy would be if we allowed that 35 percent bracket to increase back to the previous 39.6 percent?

Answer.

- An increase in the marginal individual tax rate from 35 percent to 39.6 percent would lower the incentive of small business owners to expand their firms, and that would hurt hiring.

- In 2004, 76 percent of the taxpayers who will benefit from the reduction in the top marginal rate from 39.6 percent to 35 percent have some pass-through business income or loss, so the effects of a marginal tax increase would be concentrated among small business owners.
- Our data doesn't show that the majority of these small businesses are paying taxes at the highest individual rate. While small business owners are 3 time more likely to fall into the top income class than are other taxpayers, only about 6 percent of all taxpayers with flow-through income have adjusted gross incomes over $200,000. But of all the taxpayers with adjusted gross incomes over $200,000, almost two-thirds are taxpayers with flow-through income (or losses).
- Now is perhaps the worst time to raise taxes on small business, since employment growth needs to be strengthened. We need to keep marginal tax rates low on small business to encourage expansion and hiring. Raising marginal tax rates now can only slow down job creation in the small business sector.
- The U.S. economy is always changing, and the quick, flexible response of the small business sector is one way the economy maintains its resilience in the face of unexpected shocks. Raising marginal tax rates hurts the economy's ability to weather these shocks with the minimum possible disruption.

Question 5. We, in the Senate, have been struggling to pass an energy bill. Can you comment on what impact passage of that bill could have on the economic future of this country?

Answer. Overall, higher energy prices decrease consumer purchasing power and subtract from the bottom line for business. They are a barrier to the efficient functioning of the U.S. economy.

Energy prices have been an important source of instability in our economy for several decades. For instance, oil prices soared $11 per barrel or nearly 60 percent to $30 a barrel in 2000, contributing to the economic slowdown. Prices eased back in 2001 and 2002, as economic activity slowed but then rose $5 (almost 20 percent) to $31 per barrel last year and so far this year are up another $4 on average to about $35 a barrel.

Since more than half of our petroleum products are imported, these higher prices represent more money in foreign bank accounts and a drag on US real GDP growth. Our estimates suggest that each $10 increase in the price of crude oil subtracts about one-half percentage point from real GDP growth.

Natural gas prices have also risen sharply, averaging $5.50 per MMBtu last year and roughly $5.75 so far this year—more than double the average from 1991 to 1999. Because of increased demand for the clean burning fuel, limited resources, and inadequate capacity to import liquefied natural gas, these prices are likely to remain high. This past winter, homes that heated with natural gas experienced a12 percent hike in their winter heating bill on top of a 33 percent jump the previous year.

Chemical producers who rely on natural gas for feed stock are said to be moving operations to countries where gas prices are lower.

Given the considerable hardships imposed by higher energy prices throughout the economy, I applaud every effort to pass a sound energy bill that increases U.S. supplies and decreases U.S. dependence on foreign energy sources.

Question 6. I am very intrigued by the proposals to revamp the tax-advantaged savings accounts for retirement and education and have a few questions about those proposals: the Treasury Department mentioned last year that one reason that coverage rates under employer retirement plans have not grown above 50% is the complexity and compliance costs associated with the current plans. Could you elaborate on ways that the newly proposed plans would cut down on complexity and compliance costs? Could you comment on whether the treasury department has any estimates on whether these changes could increase coverage rates—both by encouraging more companies to offer such plans and encouraging employee participating rates? Also, with regard to the proposed LSA's, has the Administration completed any estimates of how they expect overall savings rates to be influenced by enacting their proposal?

Answer. ERSAs: The Administration's proposal to consolidate the various types of employer-sponsored retirement savings plans into a single Employer Retirement Savings Account (ERSA) would be considerably simpler to administer for most employers. The most common form of employee savings plan, the 401 (k) plan, is subject to two rather complex tests that ensure that the plan does not disproportionately benefit highly compensated employees. One of these tests relates to employee deferrals, while the other test relates to employer matching and after-tax employee contributions. In 1996, Congress established safe harbor designs that employers could adopt that would avoid having to administer these tests. The safe harbors were a great step toward simplicity for those employers that could adopt them.

The Administration's ERSA proposal would greatly simplify the nondiscrimination tests by combining them into a single test. If the average percentage of compensation that is contributed to the plan on behalf of nonhighly compensated employees is greater than six percent, then the test would be satisfied. If the average percentage of compensation that is contributed on behalf of nonhighly compensated employees is six percent or less, then the average percentage of compensation that is deferred by highly compensated employees could not be more than twice the average percentage of compensation deferred by nonhighly compensated employees. In addition, the Administration's ERSA proposal would simplify the existing safe harbors and would provide a special custodial arrangement that would simplify the reporting and fiduciary rules for employers with 10 or fewer employees.

Any increase in employer sponsorship is likely to come from small firms, which are currently much less likely to offer a plan. Many factors contribute to the lower rate of retirement plan coverage for small employers, including the composition of small firms' workforce. However, the administrative costs associated with employer plans plays a role. Some of the costs of establishing and administering a retirement plan are fixed costs, and large firms are able to spread these costs over a larger number of workers. A 1996 report estimated that the administrative costs of a DC plan as a percent of payroll were 0.16 percent when 10,000 employees were covered, but were 1.44 percent when 15 employees were covered. Any reduction in the costs associated with establishing and maintaining a retirement plan would likely encourage more firms to adopt a plan.

Of the firms participating in the 2002 Small Employer Retirement Survey (SERS) conducted by the Employee Benefit Research Institute, 16 percent of those firms that did not offer a savings plan reported that high administrative and compliance costs were the most important reason for not offering a plan. Many more firms responded that the high administrative costs are, if not the most important reason, a major reason for not offering a plan.

The SERS also asked firms to assess how much more likely firms would be to offer a retirement plan if certain changes occurred. According to the study, if policy makers could create a plan with low administrative costs that did not require employer contributions, 69 percent of firms would be more likely to offer a plan. The availability of easy-to-understand information or a plan with reduced administrative requirements would make 56 percent and 53 percent of firms, respectively, more likely to offer a plan and 19 percent and 17 percent of firms, respectively, would be much more likely to offer a plan.

To give an indication of the potential magnitude of the effect of increasing coverage among small employers, if only 5 percent of small firm employees currently uncovered by a plan were to gain coverage, an additional 1 million employees would have coverage and the participation rate at small firms would increase from 26.7 percent to 29.1 percent. Larger employers are also likely to adopt plans because of the simplifications.

LSAs: The Administration's Lifetime Savings Account (LSA) proposal, along with the proposed Retirements Savings Accounts (RSAs), will result in taxpayers no longer having to sort through the maze of savings options and allocate savings accordingly. There will be one account for retirement savings and one account for savings for any other purpose, including augmenting retirement savings, health care, covering emergencies, and education.

The lack of restrictions on the use of LSA withdrawals substantially increases the likelihood that lower-income taxpayers will participate. Low-income taxpayers have traditionally been less likely to participate in IRAs and other tax-preferred savings accounts, because they have fewer resources to devote to savings. With fewer dollars to save, such taxpayers would be more likely to face a penalty if they needed the funds in an emergency and had saved in an IRA. LSAs give individuals tax-free earnings from their first dollar of savings, and withdrawals can be made at any time for any purpose with no tax or penalty.

The Treasury Department has not produced an estimate of the effect of LSAs on overall savings. Because the academic literature offers a wide range of estimates on the effect of tax incentives on savings, any single estimate would have a good deal of uncertainty. However, we believe the bulk of the evidence supports that view that tax incentives increase personal savings.

We also believe that the design of LSAs will encourage savings. As already mentioned, LSA participation will likely be high because LSAs are easy to understand and because withdrawals can be made at any time for any reason. The universal availability of LSA should also increase participation. Taxpayers can begin saving in LSAs at the beginning of the year rather than having to wait until they file their tax return and determine if they are eligible. In addition, financial institutions are likely to heavily promote the accounts. When restrictions on eligibility for IRA contributions were imposed after 1986 IRA participation rates fell, even among those still eligible to contribute. One explanation for this drop in participation is that financial institutions greatly reduced their marketing of the accounts.

RESPONSES TO QUESTIONS FROM SENATOR ROCKEFELLER

Question 1. Mr. Secretary, the budget that President Bush submitted yesterday asks this Congress to approve enormous new tax cuts in the coming years. The administration, again, claims, as it has in the past, that these tax cuts will create jobs and strengthen the economy. I am extremely skeptical of these claims.

In fact, in 2001, the President said that if we approved more than $1 trillion in tax cuts, jobs would be created. Last year, he signed into law another $350 billion in tax cuts, again saying that the tax cuts would create jobs. But as the record shows, the jobs that the President promised would result from these tax cuts have not materialized.

As you should be aware, the manufacturing sector has been particularly hard hit. In my home state of West Virginia, almost 8,000 people have lost good manufacturing jobs. Nationwide we have lost almost 3 million jobs during this tax cutting spree. And while the economy has started to rebound—as normal business cycles would predict—only 1,000 new jobs were created in December.

Mr. Secretary, today you are again asking this Committee to consider billions of dollars in additional tax cuts that will, *again*, benefit the wealthiest members of our society. But these tax cuts have not been creating jobs as you claim. Why should this Congress believe your assertions that cutting taxes again will help the economy? What evidence do you have to offer that these enormous tax cuts will actually create jobs?

Answer. We have already seen how the President's fiscal policies have helped to stimulate the economy and create jobs, starting with the tax cuts enacted in the Economic Growth and Tax Relief Reconciliation Act in 2001 and most recently with the Jobs and Growth Tax Relief Reconciliation Act of last year.

Last summer's tax relief package helped spur a sharp increase in economic activity almost immediately. Real GDP rose at close to a 6 percent annual rate in the second half of last year, the highest two-quarter pace since 1984.

The tax cuts and stronger growth contributed to a turnaround in the labor market. Since August, employment has increased for five straight months and more than a third of a million new jobs have been added to the economy.

There is still much more to be done to create jobs, however, and we believe that making the tax cuts permanent is a critical part of ensuring that job gains continue. This would reduce uncertainty and allow the many businesses that have recently increased investment and hiring to continue to do so.

Question 2. Mr. Secretary, the Economic Report the President released this week* made it painfully clear that he does not appreciate the plight of American workers.

He actually argues that the exodus of jobs overseas is good because it is just another sign of efficient trade. I am sure that some economists who spend their days in plush offices at fancy universities would say that this is sound economic theory. But Mr. Secretary, the West Virginians who have lost their jobs cannot feed their families and pay their bills on economic theories. They need a President who understands how the world really works—not in the ivory tower but on the factory floor.

Perhaps if the President had done the work I have done for more than 20 years trying to bring jobs to West Virginia he would understand that it is not enough to just blithely say that when we lose factories we will retrain our workforce and get them new jobs.

The President's Economic Report claims to recognize that as jobs are outsourced many workers will be affected and will need to find new jobs. Indeed the Report states, "Although openness to trade provides substantial benefits . . . foreign competition can require adjustment on the part of some individuals, businesses, and industries."

However, the Administration's record of compassion toward displaced workers during this period of adjustment is not very convincing. Every week an additional 80,000 workers lose their eligibility for unemployment compensation. Yet, this Administration has opposed extending benefits for workers who are still unable to find work in an economy that is simply not creating new jobs.

In light of the sluggish job growth, is the Administration willing to reconsider its opposition to extending unemployment compensation? Will you commit to helping these workers whose jobs have been outsourced in the name of economic efficiency?

* (Annual Report of the President's Council of Economic Advisors).

Answer. The President has signed extensions of unemployment compensation on three previous occasions. As we have done in the past, we will work with Congress on the issue. The most important thing we can do is to help create an environment where jobs can be created.

The President will be concerned as long as there are people who are looking for work who can't find a job. The President's top priority is creating jobs in America. He remains strongly committed to making sure every American who wants to work can find a good-paying job.

We must make sure that American workers remain the most competitive in the world. The President's plan includes actions to reduce health care costs and the tremendous lawsuit burden on this economy, to ensure an affordable, reliable energy supply, and to enable families and businesses to plan for the future by making tax relief permanent.

Today's high-quality jobs require new skills and training. People who are out of work may need help to retool or broaden their skills. The Labor Department tells us that 80 percent of the fastest-growing jobs in the U.S. require some sort of higher education after high school.

That is why the President proposed the "Jobs for the 21st Century" initiative to expand access to post-secondary education and to foster job-training partnerships between community colleges and employers in industries with the most demand for skilled workers.

The Administration spends more than $15 billion per year on education, training and employment programs and services, available through community-based "One-Stop" Career Centers.

The Trade Adjustment Assistance (TAA) program—as a result of the Trade Adjustment Assistance Reform Act of 2002 signed into law by President Bush on August 6, 2002—provides $220 million annually in training benefits for workers who have been dislocated because of increased imports or a shift of production to certain foreign countries. The reemployment benefits provided by TAA include job retraining, income support while in training, job search allowances, and relocation allowances. Under certain circumstances, income support may be paid to workers who are not enrolled in re-training. Workers receiving income support under the TAA program are also eligible to receive the Health Coverage Tax Credit (HCTC), which covers 65 percent of the premium cost for qualified health insurance.

Question 3. Mr. Secretary, many West Virginians are worried about how to provide for themselves and their families after they retire. I am very sorry to see that the President's budget actually gives them more to worry about.

Once again the President's budget proposes the creation of Lifetime Savings Accounts and Retirement Savings Accounts (so-called LSAs and RSAs). These accounts would allow individuals with the wherewithal to do so to save $10,000 each year. The earnings on these accounts would be protected from any taxation.

I fall to see how such a proposal addresses the serious needs of Americans who are trying to save for their retirement. Under current law, Individual Retirement Accounts and 401 (k) plans are already available for those people who have additional resources to set aside for their retirement. These plans enjoy tax benefits that make them attractive. Yet, we know that only 30 percent of American families currently have IRAs. And only 6 percent of workers are making the maximum contribution allowed to their 401 (k) plans.

Creating additional tax shelters for Americans who already have the extra resources to save does not make retirement more secure for the average American. In fact, by removing the incentives for small businesses to offer retirement plans to their employees, this proposal is likely to make it more difficult for average Americans to save for retirement.

Mr. Secretary, please outline for me what incentives small business owners would have to offer qualified retirement benefits to their employees if they could simply save for themselves with an LSA or RSA. And also please tell me how those incentives compare to the current incentives we have in place to encourage more small businesses to help their employees plan for retirement.

Answer. The implicit assumption underlying your question appears to be that small businesses primarily offer retirement benefits to their employees so that the owners of the business can save for retirement. We do not believe that this is true for the vast majority of small businesses.

First, the economics do not work for most small business owners: Unless the business has very few employees per owner (or owners and other key employees for whose benefit the plan is set up), the costs of providing matching contributions to lower-paid workers and administering the plan outweigh the benefits of tax preferred savings that accrue to the owners (and other high-paid workers).

Second, retirement benefits are part of a compensation package that an employer offers to employees. If employees value saving for retirement, then an employer can actually lower compensation costs by offering a combination of salary and retirement benefits rather than offering salary alone. This is because an employee values a dollar of compensation placed in a retirement account more highly than a dollar of compensation that is taxed when earned and then placed in a taxable savings account until retirement.

A recent survey of small employers (*2002 Small Employer Retirement Survey*) by the Employee Benefits Research Institute, or EBRI) confirms that few small employers offer retirement benefits primarily so the owners could save for retirement. Only 10 percent of small firms with pension plans cite benefits for key employees or owners as the most important reason for offering a plan. In contrast, 83 percent cite employee-related reasons as the most important reason for offering a plan, including a competitive advantage in employee recruitment and retention, and a positive effect on employee attitude and performance.

Even for those employers that provide retirement benefits primarily for their own benefit, LSAs and RSAs do not provide nearly as attractive an option. A small business owner can set aside up to $41,000 in an employer plan, but only $10,000 by opening an LSA and an RSA.

We think it is unlikely that LSAs and RSAs will could reduce demand for retirement benefits by employees. Employees are motivated to save in employer-based retirement plans for many reasons: the plans offer the ability to save on a pre-tax basis; the plans allow employees to save through payroll deduction; employees are encouraged to participate through savings education and/or matching contributions provided by the employer; and the plans provide employees a level of professional investment management. None of these advantages would disappear under the LSA/RSA proposal.

There is no evidence to suggest that the availability of LSAs and RSAs would cause employees to abandon saving in employer-provided retirement saving accounts. If individuals value the easy access to funds that LSAs offer more highly than they value the benefits of employer plans, current law IRAs should be preferred to employer plans. Funds in an IRA can be withdrawn penalty free for medical expenses allowable as an itemized deduction, health insurance premiums while unemployed, higher education expenses of taxpayer, spouse, child or grandchild, and first-time homebuyer expenses of up to $10,000 including for a child or a grandchild. In addition, Roth IRA contributions can be withdrawn without additional tax or penalty at any time. However, if offered, individuals overwhelmingly choose to save through employer plans rather than through IRAs. According to tabulations provided by EBRI (based on 1998 data, the latest year available), 77 percent of employees earning between $30,000 and $50,000 that were offered an employer sponsored retirement savings plan participated in the plan. In comparison, less than 7 percent of these individuals contributed to an IRA. Further, a recent study by Leonard Burman, Richard Johnson and Deborah Kobes of the Urban Institute (“Pensions, Health Insurance, and Tax Incentives”) concludes that

> “. . . restrictions enacted in 1986 on Individual Retirement Accounts (IRAs) did not significantly increase workers’ demand for employer-sponsored pensions. Similarly there is no evidence that that the increases in IRA limits enacted in 2001 will undermine employer-sponsored pension plans.”

Thus, we do not think that LSAs will cause employees to abandon savings in employer-provided plans.

Indeed, small firms would have enhanced incentives to establish an employer plan under the Administration’s proposal. The ERSA proposal would greatly simplify the administrative obligations of sponsoring a savings plan. Many employers who would have otherwise opted not to sponsor a plan would be attracted to sponsorship by the simplicity of the ERSA. The ERSA combines the simplified matching contribution requirements of a SIMPLE with the flexibility and higher contributions limits of a 401(k). Moreover, the Administration’s proposal includes a custodial ERSA for employers with 10 or fewer employees—this type of ERSA would provide even more relief from reporting and fiduciary obligations on the part of the employer.

Question 4. Mr. Secretary, the President’s budget predicts a staggering $521 billion deficit for this year. Even assuming very optimistic economic growth, all experts agree that we are facing deficits for years to come. Now, I don’t know whether recent reports are true that Vice President Cheney said “deficits don’t matter,” but let me argue today that deficits do matter very much.

Budget experts predict that next year the government will spend $180 billion on interest payments on the debt. To put that in perspective, in the same year we will be spending $179 billion on Medicaid. So let’s be clear, next year, we will spend more money paying interest on our debt than we will spend providing health care to our nation's neediest citizens. That fact alone ought to convince every policy maker that deficits do matter.

Now the President has occasionally tried to sound like a fiscal conservative and has told the American people that Congress eliminate wasteful or pork barrel spending. He uses phrases like, "Congress must tighten its belt." In his State of the Union address, the President said, deficit reduction "will require that Congress focus on priorities, cut wasteful spending, and be wise with the people's money." I would like you to explain to me how such statement could relate to fiscal responsibility.

The President has asked Congress to cut only domestic discretionary spending not related to homeland security. Now of course, you and I both know that non-homeland security, domestic discretionary spending accounts for less than $400 billion per year, or less than 18% of the annual budget. Obviously, one cannot eliminate a $521 billion deficit by being more frugal with $400 billion worth of spending—even if we eliminated all federal spending on education, all federal spending on medical research, all federal spending on environmental protection, all federal spending on health care for our veterans. You get the idea. Mr. Secretary, if Congress "tightened its belt" so much that it eliminated ALL of this spending, we would still have a deficit.

And in light of that fact, I would like you to tell me why this President continues to tell the American people that reducing the deficit is not difficult. I do not understand what difficult choices this President is prepared to make. And I would also like to know the rationale for not foregoing additional tax relief to wealthy Americans as a reasonable measure to help bring deficits under control.

Answer. We believe that controlling discretionary spending other than for defense and homeland security is one of the key elements in reducing the deficit.

As such, the President's Budget proposes statutory limits on discretionary spending, binding both the Congress and the Executive Branch to offset any increase in spending by a reduction in other spending.

Reducing discretionary spending is only one of the factors, however, that will bring the deficit down. The weak economy that we inherited was the chief cause of rising deficits, and the stronger economy that our policies helped put back on track will contribute to lowering the deficit as jobs and incomes expand.

The tax proposals included in the President's Budget, including the permanent extension of the Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA) and the Jobs and Growth Tax Relief Act of 2003 (JGTRRA), are important measures to insure economic growth and well-being. With these proposals in place, over the longer term the ratio of federal receipts to GDP will be above historic norms. Longer-run deficits therefore result from the rapid growth in outlays rather than from insufficient revenues.

The President's tax proposals will benefit taxpayers at all income levels, especially lower-income taxpayers. Permanent extension of EGTRRA and JGTRRA will lower the share of individual income taxes paid by lower-income taxpayers and increase the share paid by high-income taxpayers. Conversely, failure to extend EGTRRA and JGTRRA would increase the share of individual income taxes paid by lower income taxpayers.

Question 5. Since President Bush took office, his primary focus has been on enacting large tax cuts that unfortunately have been largely channeled to the wealthy few. I have objected to these tax cuts for that reason—because they have been skewed to benefit the wealthiest members of our society. For example, the investor tax cuts that the President championed last year are expected to cost $150 billion, even though only about 15 % of all West Virginians have any taxable income from investments. Tax cuts that could have helped thousands of my state's neediest families, like the refundable child tax credit, have been shortchanged. Good governing is about good choices—and I do not think that the choices this administration has made have been wise.

Now this budget asks for additional tax cuts, at a time when the deficits are spiraling out of control. This administration has hidden behind the War on Terror to explain the dramatic increase in deficits, but economists—and frankly any American with an ounce of common sense—can tell you that almost $2 trillion in tax cuts enacted in the last 3 years is a significant cause of the deficits.

At the same time that the President is asking for additional tax cuts, he is also asking Congress to reinstate some of the budget enforcement mechanisms that have lapsed. Specifically, he has called for spending caps and pay-as-you-go limitations on entitlement spending. However, the President has said that new tax cuts should be exempt from the kind of pay-as-you-go budget enforcement mechanisms that applied in the 1990s. I cannot understand such a request.

Considering that it would be impossible to balance the budget through spending cuts alone, even assuming very robust economic growth, how can the administration justify exempting tax cuts from the additional scrutiny associated with the pay-as-you-go budget enforcement mechanisms? Why should tax cuts be sacrosanct when we will use budget rules to hold down both discretionary and entitlement spending?

Answer. History shows that spending increases tend to be more difficult to reverse than tax reductions, which justifies requiring more difficult procedural hurdles in order to increase spending rather than reduce taxes.

Also, one of the goals of fiscal policy is to limit the aggregate cost of government, which ultimately reflects the total level of government spending, plus the dead-weight losses associated with inefficiencies in the tax system and regulatory regimes—not the level of taxes.

Question 6. Congress, in the Trade Act of 2002, expressed deep concern about the pattern of WTO decisions, particularly in. the trade remedy area, that go beyond the agreement reached when we joined the WTO. This Administration specifically has expressed its concerns that in reviewing the Continued Dumping and Subsidy Offset Act (Byrd Amendment) the WTO panel and Appellate Body exceeded their authority in finding a violation by the U.S. Congress agrees that this case reflects a classic example of overreaching by the WTO. I joined sixty-nine of my Senate colleagues on February 4, 2003 in writing to President Bush, advising him that we disagreed with the WTO's adverse ruling against the Continued Dumping and Subsidy Offset Act. We urged that the issue be addressed in negotiations within the WTO.

The Congress included in the final FY 2004 appropriations bill language that directs the Administration to negotiate a solution to that WTO ruling in ongoing trade talks. There is no support in the Congress to modify or repeal this law. Confronted with the convergence of views that the WTO panel and Appellate Body created obligations to which the U.S. never agreed, Congress' call for negotiations is a responsible course of action to address the situation at hand. Can you update us on when the Administration will be presenting its negotiating position on this matter to the WTO? Congress has asked that it receive an update every sixty days on the progress of these negotiations. Can you tell us when the first update will occur?

Answer. The Administration has staunchly defended this provision throughout a long dispute settlement process in the WTO and is working hard right now to minimize the adverse consequences on our economy of this and other cases in which the United States has been found non-compliant.

The renegotiation of existing provisions in the rules of the WTO would take place as part of comprehensive talks known as the Doha Round which are currently in a preliminary stage.

Consultations with the Congress on these and other trade negotiations are led by the Office of the U.S. Trade Representative and are ongoing. I understand that USTR is aware of this issue.

Question 7. In 2000 Congress passed the Emergency Steel Loan Guarantee Program. Since that time, this Administration has tried to find ways to undermine this program while steel companies have been using it to recover. In West Virginia, Wheeling Pittsburgh Steel has used the program from bankruptcy and is now building a state-of-the-art electric arc finance. Treasury, in the past, has opposed efforts to help our domestic steel industry and the Loan Guarantee program. Nevertheless, Congress extended this program in the final FY04 appropriations bill so that companies can continue to access the money allotted for them. The Board has at least one application penning and the possibility for others exists. As a key member of the president's Cabinet, will you support this program, and others designed to help the domestic steel industry get back on its feet and save American manufacturing jobs?

Answer. The steel import safeguard provided temporary import relief so that the Steel industry could restructure and become internationally competitive. The President feels that the temporary safeguards served their purpose.

US steel producers continue to have access to US trade remedy laws, as well as trade adjustment assistance programs.

The Steel Loan Guarantee Program was due to expire, but as you note it did not. The Administration did not support an extension. The U.S. Steel industry is undergoing substantial restructuring. We were concerned that an extension of the program could delay market-based restructuring and cause this vital U.S. industry to be less globally competitive in the long run.

Question 8. As I understand it, Chinese currency is the most undervalued major currency in the world, undervalued by something close to 60% against the dollar. That is a deliberate policy of the Chinese. This longstanding policy of the Chinese government is causing American workers to lose their jobs. The Treasury Department's *Report to Congress on International Economic Exchange Rate Policies* of October 2003 said that China has pegged its currency to the dollar at 8.28 yuan to the dollar since 1994. The report said, "This policy is not appropriate for a major economy like China and should be changed." The report noted, "Serious engagement with China on these issues will continue."

So, what has the Administration done about China's currency manipulation policy since the issuance of this report? What do you intend to do in the future? Are you concerned about what this Chinese policy is doing to American workers?

Answer. The Administration is committed to expanding employment opportunities for American workers. The most effective support for American workers and businesses is sustained strong growth in the U.S. and global economies. For this reason, it is important to continue strengthening our own economic recovery and it is why we have been working so hard with Congress to implement the President's six-point plan to promote near-term employment, economic growth and long-term competitiveness. It is also the reason that we continue to stress the need to reinvigorate worldwide economic growth with leaders of other major economies, as I did most recently at the January 6–7, G–7 Finance Ministers' meetings in Boca Raton, Florida.

Estimating the degree of under- or over-valuation of a currency is extremely difficult, particularly in an economy undergoing rapid change like China. In our view, the important question to ask is "what is the right exchange rate regime." The Administration's strong belief is that a flexible, market-determined exchange rate regime, along with free trade and free flow of capital, is best for large economies like China.

The Chinese Government is committed to moving to a flexible exchange regime, and has said so publicly, including most recently by central bank governor Zhou. We believe China should move to a flexible exchange rate regime as soon as possible.

The United States has intensified its engagement with the Chinese Government on this issue. President Bush met President Hu in September and Premier Wen in December, and the exchange rate issue was at the top of the agenda. I urged China to adopt a flexible exchange rate regime in a series of meetings with senior Chinese officials in Beijing in September. Treasury officials led an interagency technical cooperation mission to China in late February to help the Chinese government create the infrastructure necessary for a flexible exchange rate regime. Going forward, we will continue to intensify our engagement with China on the exchange rate issue, through:

- a visit to Washington by Vice Premier Huang, to continue discussions we began in Beijing,
- an appointment of a Treasury Attache at the US Embassy in Beijing to facilitate communication on this and other issues and
- a continuation of our technical cooperation efforts with the Chinese Government.

China has in the meantime made progress in preparing for a flexible regime. It has taken a series of steps to free up capital flows. For example, it has allowed insurance companies to invest parts of their portfolios in foreign assets. Most recently it liberalized FDI outflows and made preparations for Renminbi trading in Hong Kong. In addition, China is strengthening its banking system, a step which China sees as needed before it can float its exchange rate. The recent $45 billion recapitalization of two large banks is an important step as are new regulations allowing banks to increase capital with subordinated debt.

I believe that the Chinese Government is committed to moving to a flexible exchange rate regime. We will continue to encourage and assist China in order to bring about a flexible, market-determined exchange as soon as possible.

Question 9. Mr. Secretary, I am sure you are aware that I strongly disagree with the Administration on its tax cuts, and I am very troubled by this budget proposal and its revised estimates on Medicare prescription drug costs and when such estimates where known to the Administration.

I am particularly curious about how you justify such huge deficits given your responsibility as a trustee of the Social Security and Medicare Trust Funds, which face real solvency problems. Our country soon faces the retirement of the Baby Boom generation which will place enormous new demands on both Social Security and Medicare, including the prescription drug benefit. How do we financially deal with these costs?

Today over 400,000 West Virginia depend on Social Security for retirement benefits or disability and survivors' benefits—all three programs are important. How do you intend to protect these programs so they serve vulnerable families?

Privatization of Social Security costs more in the short-term than our existing program, and private accounts won't help workers who become disabled at a young age, or survivors who lose a parent in a coal mining accident or car crash. Considering that programs represent about one-third of all Social Security receipts, how will you protect those benefits?

Answer. The longer-term financing difficulties for both Social Security and Medicare are large, due mainly to demographic challenges: the "baby-boom" generation is aging, life expectancy is increasing, and the cohorts entering the workforce are relatively small. There are about three and one-half workers per beneficiary now; that number is going to fall rapidly to about 2 workers per beneficiary by 2030.

In the long run the President's tax cuts will leave the economy in a stronger position to support higher standards of living for all citizens.

The Social Security and Medicare programs are not financially sustainable in the long run and must be reformed—doing nothing is not an option. The President appointed a Commission to Strengthen Social Security in a manner that would allow individuals the opportunity to create wealth through personal accounts. Though the Administration has not endorsed any specific proposal, the Commission demonstrated the feasibility of reform with personal accounts.

Two additional principles of Social Security reform established by the President are that retirees and near-term retirees would not have their benefits affected and that reform must preserve the disability and survivor components of the Social Security program.

Therefore, the President is committed to protecting workers who become disabled at a young age or survivors who lose a parent. Such protection must be an important feature of any serious Social Security reform proposal.

Question 10. According to the Treasury Department Blue Book (p. 25), a deduction for the purchase of high-deductible health insurance through Health Savings Accounts (HSAs) would not be available to any person covered through their employer. As a result, this creates a large incentive for employers to drop coverage entirely (not even gradually phase down their subsidy to zero) and leave people to get high deductible coverage in the individual market.

I am quite disturbed to see that this budget would encourage employers to drop health coverage. People in West Virginia depend on their employers to offer health insurance coverage.

What is the Administration's rationale for wanting to undermine the employer-sponsored health system through the use of Health Savings Accounts?

Why is it that this Administration continues to try to subsidize the individual insurance market when we know that it does not guarantee a single low-income or uninsured person access to health care?

Answer. (1) We do not believe the Administration's proposal to allow an above-the-line deduction for the purchase of High Deductible Health Plans (HDHPs) in connection with HSAs encourages employers to drop health coverage for their employees. The proposal merely provides parity for individuals buying their HDHPs in the individual market with self-employed individuals or individuals whose HDHPs are provided by employers. Self-employed individuals are entitled to deduct the full amount of their HDHP premium for federal income tax purposes, whether or not they itemize deductions. Individuals who are covered by an HDHP provided through an employer generally already have the amount corresponding to the HDHP premium excluded from income above the line. Moreover, if the employer provides the HDHP, the amount corresponding to the HDHP premium is also excluded from wages for employment tax purposes.

(2) Individuals are uninsured and underinsured for a wide variety of reasons and a multi-vectored response is required for resolution. The goal of the Administration's proposals is not to subsidize the individual insurance market; rather, the proposals are designed to encourage individuals without employer-provided health insurance to purchase health coverage. Millions of uninsured persons are expected to gain health coverage as a result of these proposals. In addition, increasing the participation in the individual market may improve the market's economies of scale, enhancing its ability to assist in providing health coverage for many individuals who do not have employer-provided health insurance.

Question 11. The Administration's budget proposes the use of private collection agencies to pursue delinquent tax liabilities. The Administration explains that the $16.1 billion in outstanding taxpayer debt is currently "uncollectible due to IRS collection and resource priorities."

How does the IRS currently prioritize which taxpayer debts to pursue?

How many taxpayers account for the $16.1 billion in outstanding debt to the IRS?

I recognize that the delinquent taxpayers probably range from parties who have already been contacted more than once to those who have not been pursued to pay their debt. Please break down the pool of delinquent taxpayers and describe what attempts have been made to collect the taxes due.

The proposed budget indicates that approximately $1.5 billion could be raised over the next ten years through private debt collection. Please tell me what additional resources (number of enforcement agents, increased appropriation, etc.) would be necessary for the IRS to collect the additional $1.5 billion in delinquent taxes without contracting private collection agencies.

Answer. The IRS prioritizes outstanding tax liabilities, or taxpayer debts, based on the IRS' assessment of how each debt impacts the overall risk to compliance. Taxpayer debts determined to have a low probability of payment are considered high compliance risks. Taxpayer debts determined to have a high probability of payment are considered low compliance risks. In making these determinations, the IRS evaluates, among other things, the type of tax debt, the age of the debt, and the amount of the tax debt. For example, older debts generally have a lower likelihood of being paid. In general, the processing of a tax debt varies depending on whether it is a low, medium, or high compliance risk. Debts that are considered low compliance risks (that is, high probability of payment) are first addressed through IRS notices to the taxpayers. If the debt is not resolved by the taxpayer in response to IRS notices or by IRS Campus operations (that is, the successors to the IRS Service Centers), the debt then is processed by the IRS' automated collection sites (ACS) for taxpayer contact or further action in accordance with resource availability. Debts that are considered medium compliance risks are processed first in the same manner as a low risk case. If, however, a medium risk case is unresolved by ACS processing, then the debt is sent to the IRS' Collection Queue for assignment to the IRS' Collection Field function (that is, handling by IRS field employees such as revenue officers) based on resource availability. Debts that are considered a high compliance risks (that is, low probability of payment) are addressed first through IRS notices to the taxpayers and then are sent directly to the Collection Queue for assignment to the Collection Field function.

The $16.1 billion in outstanding tax liabilities identified in the Department of the Treasury's General Explanations of the Administration's Fiscal Year 2005 Revenue Proposals consist of 2,232,597 modules. A module is a tax liability owed for a specific tax period by a specific taxpayer. A taxpayer, therefore, may account for more than one module in the $16.1 billion. This number represents information as of November 2003 and is from the IRS' Business Performance Management System (BPMS). Based on historic ratios, these 2,232,597 modules would represent approximately 1.2 million taxpayers.

The $16.1 billion in modules consists of the following:

Individual Master File (IMF): 1.6 million modules representing $13.8 billion

Business Master File (BMF): 0.6 million modules representing $2.3 billion

For each of these delinquent accounts, the IRS has sent a series of IRS notices to the taxpayers. Notices are mailed to each taxpayer's last known address, but in many cases these addresses are not correct or are no longer current. A number of these cases may have been processed through the IRS' automated collection sites (ACS). However, given resource constraints, telephone contact with the taxpayers associated with these modules would be unlikely.

The Administration's proposal would permit private collection agencies (PCAs) to engage in specific, limited activities to support the IRS' collection efforts. The IRS is unable to continuously pursue each taxpayer with an outstanding tax liability, particularly those who have not provided the IRS with a current address. In particular, due to IRS collection and resource priorities, the IRS currently does not have the ability to collect a number of outstanding tax liabilities that the IRS believes would be paid (whether immediately or through installments) if the taxpayers were located and contacted. These tasks, which do not involve the exercise of discretion or enforcement authority, could be performed effectively by PCAs.

The IRS does not have an estimate of the number of additional IRS employees that would be required to collect the additional revenue indicated in the Administration's Fiscal Year 2005 Budget. PCAs would focus on outstanding tax liabilities that have been addressed by the IRS through its collection procedures but remain outstanding. The IRS is not directing additional collection resources to these accounts and, therefore, has not quantified the additional IRS resources that would be required to address further these accounts.

Using PCAs, however, would give the IRS much greater flexibility compared to the use of additional IRS resources. Due to hiring, training, and infrastructure issues and requirements, the IRS generally cannot absorb, in any one year, more than 20% of current capacity for any particular function. In contrast, the use of PCAs would allow the Government to reach quickly a group of taxpayers that PCAs could handle efficiently and effectively. This would allow the IRS to focus its resources on more complex cases and issues. In addition, the Administration's proposal is structured so that the PCA program can expand or contract depending on need. This "right-sized" approach is responsive to both immediate and future IRS needs.

The Administration's proposal in no way reflects a lack of commitment to an effective IRS; indeed, it is exactly the opposite. Moreover, the Administration's FY 2005 Budget continues a three-year trend of increasing resources for the IRS to improve taxpayer compliance while maintaining customer service to taxpayers. The Budget increases the total IRS budget by 4.8%—significantly above the average for non-defense, nonhomeland security discretionary spending.

RESPONSES TO QUESTIONS FROM SENATOR KYL

Question 1. In the General Explanations of the Administration's Fiscal Year 2005 Revenue Proposals the Administration makes recommendations for addressing ESC/BTI (sic) repeal, including a general (rather than targeted) corporate rate reduction. Please explain why a reduction in the corporate rate for all corporations is preferable to a reduction in the corporate rate only for manufacturers.

Answer. A rate cut for all corporations is preferable to one targeted to any particular sector because an across-the-board rate cut would reduce economic distortions, whereas a targeted rate cut would increase them. A rate cut for all corporations would reduce the current law distortions related to the corporate income tax that impose a penalty on income from investment in corporate shares, relative to income from other investments, such as partnerships and bonds. In contrast, a targeted tax cut would favor businesses and activities that qualify for the tax cut over other businesses and activities, thereby encouraging business decisions based on tax consequences rather than on economic fundamentals. These tax distortions reduce the productivity of our nation's economic resources.

In addition, a targeted tax cut would increase the complexity of the tax system because the tax-favored activities must be defined and distinguished from other activities that do not qualify. This raises difficult practical issues about the appropriate allocation of income and deductions. The complexity created by a targeted rate cut would increase compliance costs for taxpayers and enforcement costs for the IRS.

Question 2. S. 1637. The "Jumpstart Our Business Strength (JOBS) Act," includes a deduction for manufacturing income that is designed to mimic a corporate income tax rate reduction for U.S. manufacturers. In its required "complexity analysis," the Joint Committee on Taxation predicted that the corporate deduction for manufacturing income would result in increased disputes with the Internal Revenue Service as small businesses and other taxpayers seek to "characterize their activities as qualified production activities to claim the deduction under the provision." Do you believe it is wise tax or economic policy to provide a corporate rate reduction to only one segment of U.S. industry? Are you concerned that this might lead companies to shift as much of their income as possible into"manufacturing" to take advantage of the lower rate? Are you concerned that there will be an increase in audits and litigation as a result of the manufacturing deduction?

Answer. As noted above, a targeted rate cut would favor economic activity in the targeted sector and discourage it in other sectors, which could put those other sectors at a competitive disadvantage. We also are concerned that a targeted rate reduction would lead companies to shift as much income as possible into manufacturing to take advantage of the lower rate. As a result, it will be necessary to devote significant IRS audit resources to administering a targeted rate cut. Audits, particularly those involving integrated businesses, will have to focus on classification and the allocation of income and costs. Controversies between the IRS and taxpayers may increase significantly and this could increase the number of IRS appeals cases and litigated tax cases.

Question 3. Also in the complexity analysis, the JCT reported that "It should be noted that a similar provision in the Canadian tax laws was found to be highly complex and difficult to administer, which led to numerous disputes and litigation between affected taxpayers and the Canadian tax authorities. Canada recently repealed the provision and provided a general reduction in corporate tax rates." Do you recommend that we learn from Canada's experience with a manufacturing tax break structured almost exactly like the tax break provided in S.1637, and instead lower our corporate rate across the board?

Answer. Canada found the administration of their provision to be burdensome for both businesses and the government. As you note, Canada repealed its special rate for manufacturing and processing and enacted an across the board rate cut.

COMMUNICATIONS

COALITION FOR FAIR INTERNATIONAL TAXATION (C-FIT)

Contact: Washington Council Ernst & Young
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February 11, 2004

Statement of the
Coalition for Fair International Taxation

On
The Revenue Proposals
In the
President's Fiscal Year 2005 Budget

Submitted for the Record of the Hearing before the
Committee on Finance, U.S. Senate
On
February 11, 2004

The Coalition for Fair International Taxation ("C-FIT") is a group of over two-dozen U.S. employers representing a broad cross-section of industries that supports the modernization of the U.S. international tax law to ensure that U.S. companies can effectively compete at home and abroad. (Please see the attached list of companies.) We appreciate the opportunity to submit our views to the Committee.

Introduction

We applaud the Bush Administration's Fiscal Year 2005 Budget for its continued recognition of the necessity of reforming the nation's international tax provisions as an appropriate response to the World Trade Organization (WTO) rulings invalidating the Foreign Sales Corporation (FSC)/Extraterritorial Income Exclusion (ETI) provisions.

The WTO has now ruled definitively in a case initiated by the European Communities (EC) that the FSC/ETI rules violate U.S. international trade obligations, and has authorized the

EC to impose up to $4 billion in annual trade sanctions against U.S. exports. EC officials have announced their intention to begin imposing tariffs by March 1, 2004 if the United States does not comply with the WTO decision. The Administration again makes clear in its FY 2005 Budget its position that the United States should comply with the WTO ruling through the passage of legislation repealing ETI. It is imperative that the Congress pass ETI replacement legislation in order to avoid the crippling economic effects of a trans-Atlantic trade war.

As described in more detail below, C-FIT strongly supports the approach of legislation approved by the Finance Committee, the Jumpstart our Business Strength (JOBS) Act (S. 1637). That legislation brings the United States into compliance with its international trade obligations as well as meets the charge laid out to Congress in the Administration's Budget that the "ETI provisions should be replaced with tax law changes that preserve and enhance the global competitiveness of U.S.-based businesses and American workers."[1]

FSC/ETI Replacement Legislation Should Advance U.S. Economic Interests

- **In responding to the WTO FSC/ETI ruling, the Congress must take account of the vital role that U.S.-based multinational operations play in increasing U.S. exports.**

U.S. multinational corporations play a vital and leading role in the U.S. economy, and are responsible for:

- 23 million American jobs
- 9 million of the 16 million U.S. manufacturing workers
- 21% of U.S. GDP
- 56% of U.S. exports
- $131 billion in annual U.S. R&D spending and
- 49 % of U.S. corporate income tax payments

Moreover, foreign direct investment by U.S. businesses helps create markets for American products. This leads to sales in foreign markets that likely would not happen by simply exporting goods. For example, Wal-Mart, a member of C-FIT, has expanded its global reach by opening stores in foreign markets and providing additional markets for the U.S. products it sells. As a result, more U.S. products – most of them from small businesses – find their way onto foreign shelves. Small U.S. producers have a much tougher time getting onto the shelves of Wal-Mart's foreign competitors, like Carrefour, a French company.

A recent study by the Organization for Economic Cooperation and Development (OECD) found that each dollar of outward foreign direct investment led to two dollars of additional exports and a $1.70 increase in the U.S. bilateral trade surplus. The Commerce Department's "Survey of Current Business" indicates that in 2000 (the most recent year for which data are

[1] General Explanation of the Administration's Fiscal Year 2005 Revenue Proposals, Dept. Treasury (February 2004), p. 187.

available), U.S.-based multinationals accounted for about two-thirds of overall U.S. merchandise exports. Foreign affiliates of U.S.-based multinationals purchased $203 billion of goods from U.S. sources, while domestic operations of U.S.-based multinationals exported $236 billion to other foreign customers.

- **The nation's tax and trade policies should work in tandem to strengthen the U.S. economy, including by retaining headquarters of companies in the United States.**

In recent years, Congress and the Administration have recognized the economic importance of trade liberalization measures by enacting sweeping tariff reduction agreements. The domestic benefits of free trade are not only challenged by overseas trade barriers but are also being frustrated by an outdated U.S. international tax regime that acts as a trade barrier in its own right – however, this is a trade barrier we impose on ourselves.

The increasingly interdependent global economy has largely been a good thing for the U.S. economy. As the President's Council of Economic Advisors observed in 2003, "The U.S. economy is increasingly linked to the world economy through trade and investment. Domestically based multinational businesses and their foreign investment help bring the benefits of global markets back to the U.S. by providing jobs and income." [2]

U.S. international tax rules have been cited as a factor in the loss of U.S. headquarters jobs, one that may create an incentive for foreign multinationals to acquire the U.S. operations of American companies. These transactions are likely to result in the relocation of U.S. headquarters to foreign countries. A 2002 Treasury report on corporate inversions notes the growth in foreign acquisitions of U.S. businesses in recent years: $90.9 billion in 1997, $234 billion in 1998, $266.5 billion in 1999, and $340 billion in 2000. The relocation of headquarters abroad poses a serious long-term risk to the U.S. economy, to the extent that management functions move out of the United States and foreign overseers make future U.S. versus foreign investment and employment decisions. Decisions made by companies regarding the location of their headquarters affect the creation and retention of jobs in management, marketing, R&D, information technology, and other high-wage, high-skill areas. It is therefore critical that we remove those provisions in current tax law that encourages foreign multinationals to acquire U.S. companies.

- **Thousands of small U.S. businesses participate in the global economy as suppliers to U.S.-based multinational corporations.**

Thousands of small businesses support and depend on the global operations of U.S. firms. As the Small Business Administration found in a report discussing the role of small businesses in the global economy, "smaller firms can conduct international expansion on their own, or by collaborating with a multinational firm. The intermediated form of international expansion has certain advantages. The small firm benefits from having access to the multinational firm's global market reach. From the large firm's perspective, the arrangement enhances the value of its existing contributions to internationalization."[3]

[2] US Council of Economic Advisors, Economic Report of the President, 2003, p 208.

[3] SBA Office of Advocacy, "The New American Evolution: The Role and Impact of Small Firms" (June, 1998).

Accordingly, reforms that increase the international competitiveness of large U.S. based companies will have a positive impact on U.S. small businesses.

- **Congress must act to support the competitive efforts of American companies that operate in the global marketplace.**

The challenge for U.S. companies to remain competitive on an international basis has never been greater than it is today. One significant factor limiting our competitiveness is the basic structure of the U.S. international tax regime. That regime was enacted over 40 years ago when the U.S. economy dominated the world and 18 out of the top 20 global companies were headquartered here. At the time, the United States accounted for over half of the world's multinational investment. Today, to remain competitive and fuel U.S. economic growth and jobs, domestic companies must compete against foreign-owned firms for clients and customers that are located around the globe.

Defects in the Subpart F and foreign tax credit regimes cause U.S. companies to face discriminatory tax burdens not borne by their foreign competitors. Present law, in general, allows the deferral of U.S. tax on foreign earnings of U.S. companies. The Subpart F rules inappropriately impose current U.S. taxation on many types of active business income earned by U.S. companies through their foreign subsidiaries. This premature U.S. tax places the U.S. owned foreign subsidiary at a disadvantage relative to its competitors. The U.S. rules should permit active business income of foreign operations to be taxed when the earnings are paid as dividends to the U.S. parent company.

Similarly, the FTC was enacted to prevent the double taxation of income earned by U.S. companies overseas – that is, by both a foreign country and the United States. Unfortunately, the FTC has numerous arcane rules that cause double taxation of foreign-source income. The improvements to the foreign tax credit rules in H.R. 2896 go a long way toward eliminating the prospect of double taxation of foreign source income. The goal of U.S. international tax policy should be to allow U.S. companies to pay roughly the same burden of income tax as their competitors do in markets both at home and abroad.

C-FIT Supports the Approach of the JOBS Act (S. 1637)

Briefly, the Finance bill would repeal ETI over three years and replace it with a host of business tax reforms that would provide crucial benefits to all sectors of the American economy, spur the economic recovery, and create new jobs.

Improves International Competitiveness. To fuel U.S. economic growth and jobs here at home – S. 1637 would reform antiquated U.S. international tax rules (particularly in the foreign tax credit area) that undermine the international competitiveness of domestic companies.

- ***Delivers Immediate Relief.*** Businesses would receive many of the benefits included in S. 1637 as early as this year, providing a critical and timely boost to the economy.

- ***All Businesses Qualify.*** The Finance Committee bill takes account of the full range of American employers that export and compete in the global marketplace for worldwide business. The bill does not limit its benefits to corporations and thus includes small manufacturers operating as sole proprietors or partnerships. S. 1637 provides all sectors of the U.S. economy – including the valuable services and manufacturing sectors – with needed job-creating incentives.

Conclusion

The United States must comply with the WTO's FSC/ETI ruling, taking into account the interests of *all* American businesses and their workers. ETI replacement legislation should also ensure that U.S. businesses and workers are not placed at a disadvantage in relation to their foreign competitors. The WTO-mandated changes to U.S. tax law should include much needed reforms to our outmoded international tax regime because these reforms will ensure that U.S.-based companies can continue to compete globally against foreign-based companies operating under more advantageous tax regimes.

C-FIT supports the Bush Administration in its efforts to replace the FSC/ETI provisions with reforms to the international tax laws of the United States. Accordingly, we enthusiastically support the JOBS Act (S. 1637) because it meets the high bar set by the Administration: honoring the nation's WTO obligations and enhancing the competitiveness of U.S.-based businesses and American workers. We stand ready to work with the Congress and the Administration to achieve passage of this important legislation.

COALITION FOR FAIR INTERNATIONAL TAXATION (C-FIT)

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Wal-Mart

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STATEMENT FOR THE RECORD
OF THE
CREDIT UNION NATIONAL ASSOCIATION

BEFORE THE

SENATE COMMITTEE ON FINANCE

ON

"PRESIDENT'S FISCAL YEAR 2005 BUDGET"

February 12, 2004

The President's 2005 Budget, which was transmitted to the Congress on February 2, 2004, contains a number of proposals that the Credit Union National Association (CUNA) supports. CUNA represents over 90 percent of the nation's approximately 10,000 state and federally chartered credit unions and their 84 million members. We are pleased to provide comments for the record in connection with the February 12, 2004, hearing of the Senate Finance Committee on the "President's Fiscal Year 2005 Budget."

The Administration's FY 2005 budget plan would, among other things, create an Individual Development Account (IDA) tax credit and simplify personal saving by replacing existing tax-preferred saving options with Lifetime Savings Accounts (LSAs), Retirement Savings Accounts (RSAs) and Employer Retirement Savings Accounts (ERSAs).

IDAs are matched savings accounts that may be opened by persons who meet a net worth test and are eligible for the Earned Income Tax Credit or Temporary Assistance for Needy Families. The accounts are restricted to three uses: 1) buying a first home; 2) funding post-secondary education or training; or 3) starting or improving a small business. They were first authorized by the Personal Work and Responsibility Act of 1996 (P.L. 104-193). In 1998, the Assets for Independence Act (P.L. 105-285) established a five-year $125 million demonstration program administered by the Department of Health and Human Services to evaluate the effects of savings incentives on persons of limited means.

Currently, contributions are not tax deductible but are matched by contributions from a program run by a state or a participating nonprofit organization. Matching contributions and their earnings are not taxed to the individual. The Administration's IDA proposal would provide dollar-for-dollar matching contributions of up to $500 supported by a 100 percent transferable tax credit to sponsoring financial institutions. An additional $50 per account per year would be available to offset administrative costs and expenses associated with providing financial literacy training.

In this connection, CUNA notes that H.R. 7, the *"Charitable Giving Act,"* passed by the House on September 17, 2003, by a vote of 408–13, and S. 476, *The Charity, Aid, Recovery and Empowerment (CARE) Act of 2003,* passed by the Senate on April 9, 2003, by a vote of 95-5, both contain IDA expansion provisions and await further congressional action in conference. We highly commend Chairman Charles Grassley (R-IA) and Senators Max Baucus (D-MT) and Rick Santorum (R-PA) for their leadership and insight with respect to including a transferable tax credit provision in S. 476. We urge you to retain the transferable tax credit in the final agreement reached on this most important legislation.

Under the Administration's Lifetime Savings Accounts proposal, individuals of any age or income could contribute up to $5,000 annually (nondeductible) to a LSA, regardless of whether they had any earnings that year. Investment earnings and distributions from the account would be tax-free. There would be no required distributions from LSAs during the account owner's lifetime. Coverdell Education

Savings Accounts (ESAs) and Section 529 Qualified State Tuition Plans (QSTPs) could be converted to LSAs up to December 31, 2005.

We agree that these more relaxed rules could encourage individuals to save who might otherwise not do so in targeted savings plans because of restrictions on and penalties for withdrawals.

The Administration's Retirement Savings Account proposal would allow individuals of any age or income to contribute up to $5,000 per year[1] (nondeductible) from earned income to a RSA. Qualified distributions [2] would be tax-free. All other distributions would be subject to tax on amounts exceeding contributions. Current "Roth IRAs" would be renamed RSAs and would be subject to the rules for RSAs. Owners of traditional IRAs could convert them to RSAs.

We agree that RSAs would simplify the range of choices for taxpayers saving for retirement by making the Roth IRA concept available to all taxpayers. Any taxpayer could contribute up to the lesser of $5,000 or their earned income. Unlike current law, however, withdrawals could only be made for retirement, beginning at age 58. RSAs would address a key component of retirement – personal savings.

By eliminating income restrictions, the RSA could become a strong vehicle for retirement savings, particularly for those who are within a decade of beginning to retire.

The Employer Retirement Savings Accounts proposal would make many of the employer plans easier to understand. Beginning in 2005, §401(k), §403(b), Savings Incentive Match Plans for Employees (SIMPLE plans), Simplified Employee Pension (SEP) plans and governmental §457 plans would be consolidated into ERSAs, which would be available to all employers. Qualification rules under the Internal Revenue Code would be simplified.

LSAs, RSAs and ERSAs could provide additional encouragement for all taxpayers to save. <u>However, we urge you to also include and expand the current law SAVER's tax credit in the provision.</u>

American's private savings rate remains low and many low- and middle-income individuals continue to have inadequate savings or no savings at all. Lower income families remain more likely to be more budget constrained with competing needs such as food, clothing, shelter, and medical care taking a larger portion of their income. Applying the SAVER's credit to RSA and ERSA contributions would provide a needed additional tax incentive that would enhance their ability to save adequately for retirement. <u>We believe the credit should also be made refundable to be available to individuals who might not have to pay tax in any particular year.</u>

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[1] For a married couple, the maximum contribution would be the lesser of annual earned income or $10,000.
[2] Qualified distributions would be those made after age 58 or if the account owner died or became disabled.

CUNA urges Congress to pass tax legislation that would encourage all Americans to increase personal savings. We understand that Congress may address other tax matters, either as a part of this package or later in this session. Should such an opportunity arise, we request that you consider legislation that would:

- Simplify the Earned Income Tax Credit;
- Create Farm, Fish, and Ranch Risk Management Accounts ("FFARRM" accounts);
- Permanently extend the retirement and savings provisions of the Economic Growth and Tax Relief Reconciliation Act of 2001 EGTRRA;
- Permit tax free withdrawals from IRAs for charitable contributions;
- Provide a tax credit for developers of affordable single-family housing;
- Permanently extend the disclosure of tax return information for administration of student loans; and
- Extend the protections of section 7508 of the Code to all Armed Forces reservists and National Guardsmen called to active duty.

CONCLUSION

CUNA appreciates having this opportunity to present our views on the revenue provisions contained in the President's fiscal year 2005 budget proposal. We look forward to working with you in the future on these most important matters.