# DEPARTMENT OF THE TREASURY BUDGET PRIORITIES FOR FISCAL YEAR 2004

## HEARING

BEFORE THE

## COMMITTEE ON THE BUDGET HOUSE OF REPRESENTATIVES

ONE HUNDRED EIGHTH CONGRESS

FIRST SESSION

HEARING HELD IN WASHINGTON, DC, FEBRUARY 5, 2003

**Serial No. 108–2**

Printed for the use of the Committee on the Budget

Available on the Internet: http://www.access.gpo.gov/congress/house/house04.html

U.S. GOVERNMENT PRINTING OFFICE

84–884 PDF WASHINGTON : 2003

For sale by the Superintendent of Documents, U.S. Government Printing Office
Internet: bookstore.gpo.gov Phone: toll free (866) 512–1800; DC area (202) 512–1800
Fax: (202) 512–2250 Mail: Stop SSOP, Washington, DC 20402–0001

## COMMITTEE ON THE BUDGET

JIM NUSSLE, Iowa, *Chairman*

GIL GUTKNECHT, Minnesota
MAC THORNBERRY, Texas
JIM RYUN, Kansas
PAT TOOMEY, Pennsylvania
DOC HASTINGS, Washington
ROB PORTMAN, Ohio
EDWARD SCHROCK, Virginia
HENRY E. BROWN, JR., South Carolina
ANDER CRENSHAW, Florida
ADAM PUTNAM, Florida
ROGER WICKER, Mississippi
KENNY HULSHOF, Missouri
THOMAS G. TANCREDO, Colorado
DAVID VITTER, Louisiana
JO BONNER, Alabama
TRENT FRANKS, Arizona
SCOTT GARRETT, New Jersey
GRESHAM BARRETT, South Carolina
THADDEUS MCCOTTER, Michigan
MARIO DIAZ–BALART, Florida
JEB HENSARLING, Texas
[Vacant]
[Vacant]

JOHN M. SPRATT, JR., South Carolina, *Ranking Minority Member*
JAMES P. MORAN, Virginia
DARLENE HOOLEY, Oregon
TAMMY BALDWIN, Wisconsin
DENNIS MOORE, Kansas
JOHN LEWIS, Georgia
RICHARD E. NEAL, Massachusetts
ROSA DELAURO, Connecticut
CHET EDWARDS, Texas
ROBERT C. SCOTT, Virginia
HAROLD FORD, Tennessee
LOIS CAPPS, California
MIKE THOMPSON, California
BRIAN BAIRD, Washington
JIM COOPER, Tennessee
KENDRICK B. MEEK, Florida
RAHM EMMANUEL, Illinois
ARTUR DAVIS, Alabama
DENISE MAJETTE, Georgia

### PROFESSIONAL STAFF

RICH MEADE, *Chief of Staff*
THOMAS S. KAHN, *Minority Staff Director and Chief Counsel*

# CONTENTS

# DEPARTMENT OF THE TREASURY BUDGET PRIORITIES FOR FISCAL YEAR 2004

**WEDNESDAY, FEBRUARY 5, 2003**

HOUSE OF REPRESENTATIVES,
COMMITTEE ON THE BUDGET,
*Washington, DC.*

The committee met, pursuant to call, at 10:10 a.m. in room 210, Cannon House Office Building, Hon. Jim Nussle (chairman of the committee) presiding.

Members present: Representatives Nussle, Gutknecht, Toomey, Hastings, Schrock, Brown, Putnam, Wicker, Bonner, Franks, Garrett of New Jersey, Barrett of South Carolina, McCotter, Diaz-Balart, Hensarling, Spratt, Moran, Moore, Neal, Edwards, Scott, Ford, Capps, Thompson, Baird, Cooper, Meek, Davis, Emanuel, and Majette.

Chairman NUSSLE. Members and guests will take their seats. I know there is a lot of interest in this hearing, and there is obviously, today, a lot of other interesting things happening around the country and the world, and I know Members, staff and our witness will be needed in other areas of the Capitol, so I want to make sure that we begin on time.

This is the full committee hearing on the President's growth and jobs plan, the tax relief package in the President's fiscal year 2004 budget. Today's witness is the Honorable John W. Snow, Secretary, Department of the Treasury. And as I said to the Secretary prior to him taking the witness table, he has spent more time on Capitol Hill this week than he has spent in his new office. And that is part of the risks of the job, and part of the job description, of course, is to consult with Congress, and we appreciate you doing so in this manner. Today we have a number of issues that we would like to discuss with you, Mr. Secretary. I would like to welcome you.

The Secretary, upon his confirmation, became the 73rd United States Secretary of the Treasury. I look forward to working with you, and have every faith that the President has picked the right person to help strengthen and stabilize the economy and help us create jobs for all Americans.

Treasury Secretary Snow comes before us today with extensive working knowledge and expertise in economics and job creation. Secretary Snow has had a long and impressive career in both the private sector and public service to this country. He was the chairman and chief executive officer of CSX Corporation. He has served as the chairman of the Business Roundtable, and was a former co-chairman of the influential Conference Board's Blue Ribbon Commission on Public Trust and Private Enterprise. He also served as the co-chairman of the National Commission on Financial Institution Reform Recovery and Enforcement in 1992 that made the recommendations following the savings and loan crisis.

Secretary Snow's previous public service includes serving at the Department of Transportation as the Administrator of the National Highway Transportation Administration; Under Secretary, Assistant Secretary for the Governmental Affairs; and Deputy Assistant Secretary for Policy, Plans and International Affairs. Secretary Snow has a Ph.D. in economics from the University of Virginia, a law degree from George Washington University, and has taught economics in the University of Maryland, University of Virginia, as well as law at the George Washington University. He also served as a visiting fellow at the American Enterprise Institute, and distinguished fellow at the Yale School of Management.

Mr. Secretary, yesterday this committee had the opportunity to hear from the President's Director of the Office of Management and Budget, Mitch Daniels. He came presenting the President's overall budget. Today we look forward to your testimony with respect to how the President's budget proposes to strengthen and stabilize the economy and create jobs.

At the beginning of the hearing on the President's budget, I thought it was important to point out an underlying question about the budget. A question that I have, a question that this committee will continue to have as we will review it, and a question that I am sure that all Americans have, and that is: Is it a fiscally responsible blueprint for governing America during some very challenging times?

Today as we examine the Treasury Department's budget proposals as well as the President's proposal to strengthen the economy, I believe the question should be, do these proposals grow and strengthen the economy both now and in the long run?

There is no question that our economic recovery needs to gain more traction in order to create jobs and opportunities. The looming question is really how to do it, how to help it. I, for one, think we need to look longer than just this first year, but many years down the road as we consider the proposals that we have to make.

Last week, the Congressional Budget Office presented its new economic outlook numbers to this committee which showed that under current conditions, if we do nothing, we will return to surpluses somewhere around 2007, according to the Congressional Budget Office. However, if we can increase growth by only half a percent, we might be back in the black roughly a year earlier. And I will show you a chart that I believe depicts just that sentiment. Faster growth can improve or does improve the fiscal outlook. With just a half a percent, we can get back in the black, according to baseline, just in 1 year. Imagine if we can get a full percent or even more.

We also learned from the Congressional Budget report that the largest cause for the deficits we faced in the past two fiscal years has been due to a weak economy. I will show you a chart that we believe depicts that; 68 percent in fiscal year 2002, and 55 percent in fiscal year 2003 can be attributed to the economy. It seems only logical then that we must focus on measures that increase long-term growth and strengthen the economy.

It has always seemed to me that the Washington model is that we should ask families to tighten their belts year-after-year and pay higher and higher taxes to fund additional Washington spending, but we never seem to ask Washington to tighten its belt so that the American people can keep more of their money. So spending restraint will be a hallmark of the budget that we present. I think the President, though, hit the nail on the head last week during the State of the Union Address when he said, quote, “Jobs are created when the economy grows. The economy grows when Americans have more money to spend and invest, and the best and fairest way to make sure Americans have that money is not to tax it away in the first place.” It seems pretty basic, it seems pretty logical, and it seems like a good foundation for a policy that we can build on.

So, the highest priority in crafting the budget will be promoting the overall strength and stability of our country; strength and stability in our defense, strength and stability in our homeland security, and that is strength and stability in our economy. The lesson of the last 2 years is that there is no substitute—no substitute for the strength and stability of America and our economy. And that is the subject of today’s hearing, our economy, how to strengthen and stabilize it for the long term.

And with that, I turn to my friend and colleague Mr. Spratt for any opening comments he would like to make.

[The prepared statement of Mr. Nussle follows:]

PREPARED STATEMENT OF HON. JIM NUSSLE, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF IOWA

Good morning.

When President Bush submitted his fiscal year 2004 budget yesterday, the underlying question for me was: is it a fiscally responsible blueprint for governing?

From what I have read at this point, and based on the ambitious agenda he laid out in last week’s State of the Union speech, the answer seems to be yes.

The President’s critics will scoff at that. They will point to the substantial near-term deficits in the budget deficits that the President and his aides have not glossed over. Those deficits are troubling especially coming just 2 years after we anticipated budget surpluses as far as the eye can see.

But we all know what happened. Our economy, which had slowed dramatically in 2000, slid into recession just as President Bush took office. Later that year, terrorism struck here on our own soil, further challenging our national and economic confidence. Our necessary response rebuilding and shoring up here at home, and taking on terrorism where it breeds, overseas has required a commitment of will and resources.

All these factors are still active today. At the same time, we continue to face increasingly urgent demands in areas such as education and health care. Budget deficits are among the results.

But fiscal responsibility is not just about making numbers add up a certain way. It is fundamentally about governing; and governing requires striking a balance among competing demands, weighing desires against needs, and facing obligations not only to today’s generation, but also to tomorrow’s.

Today’s principal obligations are clear. We must prevail in the war against terrorism, committing all the resources necessary for that task.

We must provide for and enhance the security of our homeland. This is not a one-time job; it is a permanent and ongoing task especially when we are trying to protect ourselves against evil minds who spend all their time calculating ways to terrorize and kill.

Both of these, along with the other needs cited above will require government spending and will result in continued deficits for a time. But what matters is that we don’t lose control of spending. We must not commit to strategies that win popular support today, only to balloon in costs that will be imposed on our own children.

Last, but most important, we must help restore the strength and stability of our economy. According to last week's projections by the Congressional Budget Office, without action, this economy will continue to limp along with unemployment rates at about 6 percent for the next several years. This is not acceptable to the President; it is not acceptable to me; above all, it is not acceptable to all those families struggling to make ends meet. It takes a growing economy to provides jobs and opportunities which restores Americans' hope that they can make their lives better through their own efforts.

When it comes to stabilizing and strengthening the economy, most of the "stimulus" plans I have heard of focus only on the short-term, which does not provide either the stability or the long term strengthening that is needed. Such proposals are the economic equivalent of a crash diet versus a healthy lifestyle.

The President's plan, in contrast, recognizes that families and businesses need to be able to plan for the future. Whether it is a family planning for it child's education or a business looking at a capital expenditure, we need short-term and long-term solutions. People who are out of work don't just need a job for the rest of year; they need jobs that will be created to last for years to come.

At the same time we do need to be very careful about controlling spending.

Our current situation is very much like the situation many families throughout the country are facing. When faced with tough times, they still buy the family groceries and cover the cost of emergencies but don't remodel their kitchen.

As we begin to construct this year's budget we must adhere to this same principle.

While I support the goal of ending deficits, the highest priority in crafting the budget will be promoting the overall strength and stability of our country.

There is no question that we face trying times but we have done so in the past and have always come out stronger as a nation and as a people.

We must restore the stability and strength of this economy and this nation.

Our budgets need to look beyond the next election and toward the next generation.

Mr. SPRATT. Mr. Snow, welcome to our committee. You bring impressive credentials and experience to the Treasury, and we look forward to working with you over the years to come. Among those welcoming your coming indirectly was an organization that you used to belong to named the Concord Coalition. I believe you were a prominent and ardent member of that organization. On Sunday, the Concord Coalition published a full-page ad in the New York Times—I didn't know they had that kind of money. It's a manifesto, really, about the Bush budget. And here is what they said, the organization of which you were once a very ardent and enthusiastic member:

"Guns and butter and tax cuts, can we have it all? To enact permanent new tax cuts in the face of new spending pressures, the prospect of war in Iraq, inevitable postwar costs, massive but indispensable homeland security, a major prescription drug add-on for Medicare is to proclaim that America can painlessly have it all. Unfortunately, we can't. Sooner or later someone has to pay the bill for guns and butter and tax cuts. Many worry about class warfare. Almost no one seems to be worried about another form of warfare, generational warfare. That is what we risk if we continue to live beyond our means and to pass the IOUs on to our children and grandchildren."

They go on to say: "When is a tax cut not really a real tax cut? Many advocates of permanent tax cuts apparently believe that debt is a painless alternative to taxes. In fact, deficits merely shift the tax burden into the future. But haven't we shifted more than enough onto our children and grandchildren? According to Social Security and Medicare trustees, these two programs are on track to consume between a quarter and a third of worker payroll. This is an unthinkable burden. Adding more would be unconscionable. At a time when the young men and women of the Armed Forces are being asked to risk their lives, make the ultimate sacrifice, are the rest of us going to sacrifice by shifting even more of our tax burden onto future generations?"

A pretty strong statement, and it is on our minds very much.

One of the things that we are proud of, Mr. Secretary, is that during the 1990s we moved the budget deficit from $290 billion in the red in 1992—fiscal year 1992, the last year of the Bush administration—to a surplus of $236 billion in the year 2000. That was a phenomenal accomplishment, and a lot of things converged to make it all happen. Now we are seeing the slow unraveling of the discipline that made it happen. This is one of our favorite charts because it shows what happened in the Clinton years. He inherited a $290 billion deficit, the biggest in peacetime history, and moved it over 8 years—the bottom line of the budget getting better every one of those 8 years—moved it out of deficit into surplus to the tune of $236 billion.

Among other things, that made it possible when the Bush administration came to office for us to be having an earnest debate here about actually repaying some of the national debt as a prelude to saving and making solvent Social Security and Medicare for the long run. This would be our way to pave the way for the baby boomers' retirement, which begins to occur in 2008, 77 million baby boomers marching to their retirement right now, the first to retire in 2008.

Let me show you a simple linear graph that depicts—this is chart No. 7—the path that we were on when we began the Bush administration. The curve marked February 2001 shows you the curve that we anticipated following in order to diminish, pay back, buy back the Federal debt held by the public. And we had a realistic prospect of paying all that debt off by 2011. I don't think we would have ever reached that point, but nevertheless we had a path plotted to do that. Both sides were working in concert on that.

The upper curve is where we are now, February 2003, just 2 years, and the difference is $5 trillion. That is a stunning estimate of the situation we find ourselves in. We have seen a fiscal reversal of $7.8 trillion. We have gone from a surplus projected in 2001 of $5.6 trillion today, if we implement the policies you propose today, of a cumulative deficit of $2.2 trillion. That is a $7.8 trillion swing, and I think you would agree it is a swing in the wrong direction. We are going the wrong way.

The problem we have looking at this budget—could I have chart No. 12—is as we look across the top line and exclude the Social Security Trust Fund, because, after all, it is a trust fund, we have by law said it should be taken off budget. We have had motions in this committee to adopt amendments and make permanent law a provision that would have made it illegal to ever combine the two accounts. In any event, we think it is proper to focus on the budget deficit and the general accounts of the budget, the basic budget of the United States, and look at the top line.

The chairman was just talking about seeing some daylight at the end of this forecast period. I don't see any. The deficit this year and the general accounts to the budget, excluding Social Security, is going to be $468 billion. That is before any cost is attributed to fighting the war in Afghanistan. By 2008, it declines to $433 billion. Between 2004–08, 5 years, we accumulate $2.140 trillion in additional debt. Now, some of it we are able to put in the Social Security Trust Fund, but it is still debt of the United States, it is an obligation that has to be paid, and we just don't believe that that is a path we should be taking.

And let me show you chart No. 6. We have had an economic downturn that was not forecast in January of 2001. OMB is now saying that of the $5.6 trillion surplus, $3.2 trillion has disappeared because of economic adjustments. So that is tantamount to saying the surplus was overstated by 60 percent to start with—40 percent to start with. But in any event, this shows the additional tax cuts that you have got right now. By OMB's estimation, if you did nothing further, we would have gone from a $5.6 trillion, to a $129 billion deficit, cumulative deficit, between now and 2011. From $5.6 trillion down to $129 billion.

The additional $2 trillion that is showing up on the bottom line of the budget you are presenting us, the additional $2 trillion in debt and deficits that we are going to be incurring are because of policy choices you are proposing in this budget, and the lion's share of those policy choices that leads us to bigger deficits is shown right there in the tax cuts that are being proposed by this administration. It will cost about $600 billion to make permanent the 2001 tax cuts. It will cost a little more than $600 billion if we adopt the so-called jobs and growth package that you presented. We think it is an antigrowth package because it adds debt, and debt in turn will stifle growth in the economy.

And finally, we don't think you can find a way around, nor we—we are both in the same box—on the alternative minimum tax. Between now and the end of this forecast period, we have got to deal with the problem and the cost of fixing the AMT so that 340 million taxpayers aren't affected by the alternative minimum tax, which is substantial. It is at least $600 billion itself.

If you put those three together, that is over $1.8 trillion on your tax agenda. You may not have the AMT actually displayed in your budget this year, but there is no way around it. Congress and the administration will have to deal with it, and we want to talk to you about that in the question period. But if you put those three together, that is $2 trillion. If you add everything up and adjust it for debt service, that is $4.4 trillion. That is why this budget is sagging. That is why we have got the bottom line going into the red, mired in the red in deficit for as far as the eye can see.

Those are our concerns. We would like to get back to the path we were on when we were paying down debt and preparing for the retirement of the baby boomers, shoring up Social Security and Medicare for the long run. And frankly, as we look at your budget, we don't see how you get there. It is not just the fact that we see a dire picture of deficits as far as we can forecast, but that there is no plan spelled out here for the resolution of that problem. So we fear that we are seeing a cyclical deficit become a structural deficit and becoming every more—every year in your budget becoming more intractable.

Respectfully, that is what we submit our concerns to be, and that is why we are glad to have you here today. We want to ask you some serious questions about this situation.

Chairman NUSSLE. Without objection, all members will be allowed to put a statement in the record at this point.

Mr. Secretary, welcome to the committee. This is your first opportunity before the House Budget Committee. We hope it is not your last. But we do hope in the intervening period you do have the opportunity to go in and set up your office and begin to work, and not spend your entire career on Capitol Hill; but we are glad that you are with us today and willing to spend some time with us. Welcome, and we are pleased to receive your testimony at this time.

**STATEMENT OF JOHN W. SNOW, SECRETARY OF THE TREASURY**

Secretary SNOW. Mr. Chairman, thank you very much for that gracious welcome to the committee, and, Ranking Member Spratt, distinguished members of the committee, it is an honor to be here before you on my second day on the job. You are going to have a lot more in-depth knowledge of a lot of these issues than I will, but I am going to struggle through and do my best, and in the weeks and months ahead I look forward to getting much, much better acquainted.

I think the chairman and the ranking member framed the issues we need to deal with extremely well, and I look forward to engaging on those very pared set of issues in the months ahead.

Let me begin by addressing some of those issues and by offering my views on what I take to be the essential background for the budget. First, the economy, the condition the economy is in and how we got there; and then turn to the President's economic growth plan, which I think promises creation of real jobs, acceleration of the recovery that we are on but which is a little wobbly; and for the longer term going to the Congressman Spratt's set of issues and the chairman's set of issues, higher growth rates, the higher growth rates that will enable us to meet those unfunded promises, those huge promises to the future that we made to future generations, and to have the flexibility that real output and wealth and a bigger economy gives us to deal with whatever issues the country may face.

As every American knows by now, whether from having lost a job, from knowing someone who has lost a job, or from worrying simply about losing their own job, our economy took a turn for the worse beginning in the summer of 2000. I come out of the transportation business, and I will remember forever looking at the carload numbers and the containerload numbers and the bargeload numbers and the truckload numbers that came across my desk as a private citizen running a large transportation company in the summer of July of 2000. It was a striking downturn that began. It wasn't seen in the rest of the economy for some months to come, but the industrial sector began a long downturn that still isn't in a state of recovery, a 2 year—probably the longest downturn of the industrial sector that we have experienced in two or three decades.

By the time President Bush took office, that undercurrent was running strongly against the economy, and we were clearly in a period of declining growth heading into a recession. The unprovoked and unprecedented terrorist attacks of September 11, compounded those economic difficulties, compounded a recession that was already by that time well under way. At the same time, the discovery of the abuses that were apparent in some corporate businesses and on the part of some corporate business leaders slowed the recovery further and undermined confidence in our equity markets and in our capital markets.

In response to this confluence of adverse events, the President led decisively, and acting with the Congress in a bipartisan fashion took the steps necessary to protect a shaken Nation and a fragile economy. In 2001, when relief was most needed, he signed a sweeping tax relief package, the most sweeping in a generation, and as evidence of the damage to the economy became clearer and clearer in 2002, March, acted again to further bolster the economy.

From my point of view, this was precisely the right medicine administered at precisely the right time. These actions—and I commend the Congress for your action—these actions were essential to avoid a much deeper and much harsher downturn. And the actions made the recession the shortest and, I think, the shallowest in modern times—the mildest since World War II. I am absolutely convinced that without these measures—and certainly they added to those deficit numbers that were on the charts that you showed me—but without these measures, we surely would have had a much deeper and much more difficult recession to contend with.

In the face of extreme adversity, our economy, like our Nation, remains resilient. Despite the economic slowdown, the attack on our homeland, the war in Afghanistan, weakened investor confidence, and the current uncertainty surrounding the economy as a result of the Iraqi situation, the economy is recovering, but the problem is it is not recovering on a fast enough pace or a sure enough pace. And as the President has said, we can and we must do better. Relative success isn't sufficient. Relative success isn't enough. Too many Americans are out of work today, and too many Americans are insecure about their tomorrows. As long as there are Americans who want a job and can't find one, the economy isn't growing fast enough.

That is why the President's jobs and growth package is so important. Under that proposal, 92 million taxpayers and their families would receive tax relief this year. A typical family of four with earnings of $39,000 would receive total tax relief of over $1,000, I think it is $1,100-some, compared to the taxes they paid in 2002. And importantly, they would get that tax relief not just in 2003, they would get that tax relief year in and year out thereafter, each and every year thereafter. And his plan will create hundreds of thousands of additional jobs by the end of this year and well over a million by the fourth quarter of 2004.

The package will not only help America return to its economic potential—and this is an important point that I am sure the committee will want to join with me—it will increase that potential. It will put us on a higher growth path. It will eliminate inefficiencies in the economy, distortions in equity markets, and, by doing so, will increase the output of the economy. It will create a more abundant future with more good jobs and greater capacity to address these problems. I think that is what everyone in this room, and everyone across America is seeking.

Before I turn to the budget, let me offer a word on deficits. Congressman Spratt is correct. I have been a hawk on deficits in the past. I was a hawk on deficits—and you will want to question me on this—at a time when we were in an entirely different world. I was a proponent of the balanced budget amendment with President Bush during his—first President Bush—during his administration. I was active in the Business Roundtable in bringing about the balanced budget agreement between the Congress and the administration in the mid-1990s, and I am proud of that.

Let me be clear: Deficits matter. Deficits are important. They are never welcome, but there are times, times like these, when they are unavoidable, particularly when we are compelled to address critical national needs as we are today. Are these deficits welcome? Absolutely not. Are they understandable? Yes, indeed.

The surpluses that were talked about that we enjoyed were the product of a strong economy, not a weak economy. We will not return to economic strength by taxing the economy further when it is struggling any more than we would increase our Nation's security by failing to fund its defense when we are threatened. The prescription for returning to balanced budgets is pretty straightforward. I think the chairman talked about it in his opening comments. Hold the line on spending and grow the economy. Pick the economic growth up half a point, a quarter of a point, three-quarters of a point, and we get entirely different numbers. Hold spending a half a point or a quarter of a point compounded with higher growth, we get entirely different numbers. This is the direction the President has chosen of course, to create real jobs, more real jobs that last, and, of course, to put the Nation on a higher growth path for the future.

Mr. Chairman, I look forward to responding to the questions of the committee and working with the committee in hopefully the months and weeks—the weeks and months ahead. Thank you very much.

Chairman NUSSLE. Thank you, Mr. Secretary. And again, welcome to the committee, and good luck with and congratulations on your new position.

[The prepared statement of Secretary Snow follows:]

PREPARED STATEMENT OF HON. JOHN W. SNOW, SECRETARY, DEPARTMENT OF THE TREASURY

Chairman Nussle, Ranking Member Spratt, and distinguished members of the Budget Committee, I welcome the opportunity to appear before you today to discuss the President's budget for fiscal year 2004.

Let me begin by offering my views on the essential background for this budget: the United States economy and President Bush's economic growth plan, which promises to create jobs, accelerate America's economic recovery, and increase our growth for years to come.

As every American knows by now—whether from having lost a job, knowing someone who has, or worrying about losing theirs—our economy took a turn for the worse beginning in the summer of 2000. By the time President Bush took office an undercurrent was running against the economy. The unprovoked and unprecedented terrorist attacks of September 11, 2001 compounded a recession that was well underway, while the discovery of serious abuses of trust by some corporate business leaders slowed our recovery from it.

In response to this confluence of adverse events, President Bush led decisively. Acting with Congress in a bipartisan fashion, he took the steps necessary to protect a shaken nation and a fragile economy. In 2001 when relief was needed, he signed the most sweeping tax relief in a generation. As evidence of the damage became clearer, he acted again in March 2002 to further bolster the economy. This was precisely the right medicine at precisely the right time. These actions made the recession shorter and shallower than it would have been. In fact, by most measures it was the mildest since World War II.

In the face of extreme adversity, our economy, like our nation, remains resilient. Despite a sequence of economic slowdown, attack on our homeland, war in Afghanistan, and weakened investor confidence, the economy is recovering. But as the President has stated, we can and must do better. Relative success is not sufficient. Too many Americans are out of work today, and too many Americans are insecure about their tomorrows.

We must build on the proven strengths of our economy. We must continue to move toward policies that will create more good jobs and raise living standards for all. As long as there are Americans who want a job and cannot find one, the economy is not growing fast enough. That's why President Bush's jobs and growth package is so important. Under the President's proposal, 92 million taxpayers and their families would receive a tax cut in 2003. A typical family of four with two earners making a combined $39,000 will receive a total of $1,100 in tax relief, compared to the taxes they paid in 2002, under the President's plan—and not just this year, but in each and every year after. And his plan will create hundreds of thousand of additional jobs by the end of this year and well over a million more by the end of next year.

The package will not only help America return to its economic potential, it will increase it, creating a more abundant future with more good jobs and raising real wages. I believe that is what everyone in this room and across America seeks.

Before I turn to the budget, a word about deficits. Deficits matter. They are never welcome. But there are times, such as these, when they are unavoidable, particularly when we are compelled to address critical national needs. It is important to remember, even without the President's economic growth and jobs package, homeland security, and the war on terrorism, we would have deficits now. Are these deficits welcome? No. Are they understandable? Yes.

The surpluses we enjoyed were the product of a strong economy, not a weak one. We will not return to economic strength by taxing our economy when it is struggling, any more than we would increase our nation's security by failing to fund its defense when it is threatened. The prescription for returning to balanced budgets is straightforward: hold the line on spending and grow the economy. This is the direction the President has chosen: a course to create real jobs that last. We are not going to let terrorism and its effects bring either our Nation or our economy to its knees.

Finally, we should remember that current deficits are small relative to our unique circumstances and to our economy as a whole. Even at their depth, they remain considerably below the typical levels following a recession over the last 30 years and they begin a pronounced improvement after next year.

We face new threats and challenges. Job creation and economic growth are keys not only to our near-term but our long-term success as well. If we are to meet the threats of today and the challenges of tomorrow, we must have a strong economy. In fact, we must seek a higher level of prosperity for America than we have known—one which puts us on an even higher growth path, one which unlocks the fullest potential and talents of the American people. That means encouraging hard work, rewarding hard work, and creating the opportunities for work for all Americans. These are the values that brought America to where we are today and they are the ones that we must allow to lead us into the future. We must also remember that our success and our example in this endeavor promises not only a brighter, better future for our people and our children, but for the rest of the world as well.

The Jobs and Growth Package, our new initiatives to promote savings, our proposal to promote health care coverage, to encourage charitable giving, and to promote responsible energy production, and improved compliance measures from the Internal Revenue Service are all important budget initiatives. Each of these is described in more detail in our request.

The Treasury Department's portion of the 2004 budget is nearly a third reduced from 2003, owing mainly to the separation of homeland security functions from the Treasury Department this year. Adjusting for that change, Treasury's request is an increase of about 3.5 percent over last year's request.

Treasury's budget request will allow us to build on our recent accomplishments and highlights our commitments to:

1. Fight the war against terrorist financing;
2. Ensure that the tax system is fair for all Americans through a comprehensive compliance effort that includes high income taxpayers;
3. Increase Treasury's efficiency and effectiveness by streamlining operations; and

4. Maintain the integrity of our nation's financial systems and currency.

I look forward to discussing that plan and the rest of the President's budget with you today.

Chairman NUSSLE. I guess I want to start with what you said we ought to question you on, and that is you are a deficit hawk. And like so many people around here, the words of the last 10 years have been put to music about balancing the budget, keeping it balanced, you know, never going back to those days when we were running deficits, some would say, as far as the eye can see.

How did we get here? How did we get to this point? You say deficits matter. We all think deficits matter, I would say, and I believe that is now joined in a bipartisan way. So if deficits matter, A, how did we get here, and B, what are we going to do about it?

Secretary SNOW. One of the charts that was put up suggested where the biggest part of the problem lay: The economic slowdown, which has cost us over $3 trillion from those forecasted surpluses of just a few years ago. We didn't squander that surplus. We never had it. It was a forecast. It wasn't real dollars in hand.

And I think the thing to keep in mind here is just how humble people who make forecasts should be; that the economic slowdown was not foreseen. The slowdown in the growth of Government revenues, which was greater than the slowdown in the economy, wasn't foreseen any more than at the end of the 1990s—1996, 1997, 1998, the vast increase in governmental revenues was foreseen. That vast surge in governmental revenues was the product of what? It seems to me it was clear. It was the product of a very buoyant and unsustainable stock market that created a lot of capital gains taxes for the Federal Government that had not been in the budget before and which are not there today. It created an awful lot of revenue for the Federal Government growing out of the exercise of options at a time when options were buoyed up by this very effervescent stock market, by incentive compensation that was a primary part of corporate world that ballooned during this period and created lots of additional and unforeseen revenues at the Federal Government.

That is over now. It disappeared. And the economic slowdown and the consequence of the stock market decline, I think, are the single most important factors in explaining the difference between where we were several years ago and where we are today, to say nothing of the cost of the war on terrorism and the economic uncertainty that goes with the Iraqi situation.

Chairman NUSSLE. Well, let me hone in then on revenues, since that is the reason why the bottom line has changed so dramatically is the revenues have not come in. We can talk about the fact that there was additional emergency spending, there was certainly new homeland security spending, there was spending certainly over and above what was anticipated that certainly contributed to it. But the economic downturn had quite a bit to do with the lack of revenues coming into the Treasury. As you said, it was not predicted, it was not forecasted. I am dying to ask, why? I mean, we missed—and when I say we, I mean CBO, OMB, and Treasury, missed these forecasts by $50 billion at a chunk. Why? How can this be within 6 months—and this is your second day, so I guess the passion behind the question is that hopefully this has got to be one of the first issues that is tackled.

And let me put out a suggestion as to what might be going on. Our tax system that we have right now, we cannot predict the revenue that it will generate. The current tax system has gotten so complicated, so convoluted, so based on things that are outside of anybody's control that no human being now is able to predict what it will generate, because for the first time, as I understand it, since 1929, regardless of where the economy was going and heading, this is the first 2-year period that revenues actually dropped in actual dollars from the previous year. And to me that is a signal of the Tax Code and our inability to manage revenues more than probably any other issue that is out there. And I'd ask your comment or observations on that.

Secretary SNOW. I think you are putting your finger on a very important issue here. Predicting the economy is one thing, and predicting the revenues that go to the Federal Government as a consequence of changes in the economy is another. The latter seems to have greater margins of error in it than the margins of error associated with predicting the economy. So the revenue stream is even more uncertain than the economy itself, which has always got a measure of uncertainty about it. So clearly, there is a disconnect. It is a disconnect I don't think we understand. And the best people in the world of understanding these things are beside me here and over at the Treasury Department and up here in the Congress. We all missed it. We all missed it big. As I said, I think, earlier, it ought to make us humble, and it ought to make us go back and think harder about these interconnections between the economy, the Tax Code, and the Government's revenue streams.

Chairman NUSSLE. All right. But then if that is the case, if we can't forecast tomorrow and can't forecast next year, let us just not do anything. Let us just freeze where we are. Let us freeze spending; let us not change the Tax Code. According to CBO, we grow out of it. According to OMB, we will grow out of it in 2 or 3 years. Let us not do anything.

Why is the President suggesting at this moment in time that we do something? And I am asking you this, to some extent, tongue in cheek. I mean, we are supposed to freeze at this moment in time and do nothing as a government? We are not supposed to change the tax policy of this country? That is what I hear so many people saying: Don't do anything. Well, in 2 or 3 years we will be out of it. I mean, is that true, that all of a sudden we are going to grow out of it in 2 or 3 years by doing nothing over those next 2 or 3 years?

Secretary SNOW. No. I think the President's program is animated by the answer to your question, which is, no, we can't leave it the way it is. We need to take the steps to assure that the recovery, which will generate additional revenues—that the recovery stays in place and accelerates; that those additional jobs are created; that the economy grows in the short term. But more importantly, because this package is—the President's growth program—has got a long-term component as well as a short-term component that I hope we will be able to get into later, it assists the economy now. It creates some 500,000 additional jobs by year end, the fourth quarter of this year, a million and 3 or 4 by the fourth quarter of next year. That is a lot of jobs.

Now, that helps a lot of people who are out looking for work. I want to see as many "Help Wanted" signs going up all over America as possible. But what we need to do is get this economy on a higher growth path long term. The way to do that, I think, is to take actions like those the President proposes on the dividend, because clearly, the double taxation of dividends weakens the economy. It distorts the economy. If you tax equity capital more, you get less of it. If you tax anything, you get less of it. And so we have less equity capital. As a consequence, we have more debt in the system than we otherwise would have. And I am—we will get into this later, but the important thing about the package is that it serves both short-term and critically important long-term goals of speeding up the economy in the short term, assuring more jobs, and putting us on that more abundant growth path in the future, which allows us to address these questions that are on your mind.

Chairman NUSSLE. I have had a chance to talk to a few Iowa business folks, big employers within my district and State, and who were similarly situated to yourself not too long ago, and I asked them what we need to do to create jobs. And I will tell you, what they tell me is that there is money out there—a lot of people sitting on money right now. A lot of people are sitting, waiting. They are waiting because of lack of confidence, on one hand. They tell me they are waiting because of the uncertainty over the war that is looming. And they tell me they are just uncertain about the future.

And so, I guess, my last question would be, having sat in that situation not too long ago around the boardroom table making decisions about product lines and job creation and actually creating a job, unlike the Government which hasn't created a job except a government job in its entire existence, tell us what is the trigger. What is the trigger? With low interest rates right now and the cost of capital as low as it has ever been, what is the trigger to get someone like yourself who sits around that table, whether it is a big boardroom table or it is a small business kitchen table at home, that triggers them to create that next one or two jobs? What is the trigger? What is the way that we can get this thing going?

Secretary SNOW. I think the main trigger is confidence, and confidence comes from people seeing their disposable income rise, and seeing it rise not just in a one-time event, but the prospect for a permanent increase in what they can take home, what they can spend, what they really have, their after-tax income in their pocket going up.

That is what this first and foremost does. It puts lots of additional money in the hands of 92 million Americans. That will stimulate the economy because it will give people confidence in their future. And it is the multiple-year aspect of this. Making these future tax cuts permanent will telescope to the future and cause people to say, wow, I am going to have another $1,000 a year, I am going to have another $2,000 a year to spend. It makes them feel more confident about their future.

Business will respond as consumers—as they see the prospects for their business improving, as they see their returns improving. An important feature of this legislation is that small businesses, which are the biggest job generator in America, will find themselves with more net income and more cash flow. They will have more cash flow and net income because of the expensing provision, which is an attractive and important feature of the bill, but also because of the reduction in the marginal tax rates. And of course, so many small businesses use the flow-through method of paying taxes, they will find their marginal tax rates being reduced. As their marginal tax rates are reduced, what does that mean? It means their business is more profitable. As their business becomes more profitable, has more free cash flow, they are more inclined to go out and expand to take on additional customers, to make some capital investments, and to put up those help wanted signs that I said earlier I would like to see more of going up all over America.

Chairman NUSSLE. Thank you, Mr. Secretary.

Mr. Spratt.

Mr. SPRATT. Thank you, Mr. Chairman.

Mr. Secretary, I was here during the 1980s and here during the 1990s, and you were a close observer of the process then, I think you would agree. The way we got to where we were in 2000, with a surplus of $236 billion and the bottom line of the budget that it improved every year that the Clinton administration was in office is that we had a plan and we had a process. The process grew out of the Budget Enforcement Act of 1990, which we adopted as part of the budget summit agreement made with Mr. Bush, laying the foundation for what happened in the 1990s.

Those rules are now all gone. The PAYGO rule is gone, discretionary spending ceilings are gone, sequestration is gone. All of the disciplines are gone. And the last vestige of any kind of budget plan expired last year. We have no plan; we have no process. So how do we get rid of these enormous deficits and back to a balanced budget without a plan and without a process?

Now, I know that you are proposing the renewal of some of these budget process provisions such as the PAYGO rule. There is an old adage around here that it is pay as you go, and that you pay, and I will get a free ride. That is a typical attitude on both sides of the aisle among all Members of Congress.

As I understand it, you want to renew that rule, but you don't want it applied your proposals; it won't apply to your tax cuts, and it won't apply to your entitlement increases; is that correct?

Secretary SNOW. Congressman, the PAYGO rules and the other sequestration rules and those things that came about in the 1990s were good policies. I supported those at that time. We got to those good numbers you are looking at because of those rules in part where spending was under much tighter control in that period of the mid-1990s on than it had been heretofore. And I forget precisely what it was, but over about a 5- or 6-year period there, spending rose at less than the rate of inflation, I think.

Mr. SPRATT. But we had a plan, and we had to limit it someplace at least. We didn't always adhere to it, we fudged on it, but nevertheless it constrained spending significantly and achieved results. Alan Greenspan sat there and said, I will admit, I was a cynic. I was a skeptic. I didn't think it would work. But I have to say—he said—I think that this contributed successfully to the successes of the 1990s.

Secretary SNOW. I take some pride in having been associated with groups that were in the forefront of urging Congress to adopt those rules. I don't think it was the Concord Coalition that I was a member of, though.

Mr. SPRATT. I beg your pardon?

Secretary SNOW. But, you know, I know Pete Peterson and the Concord Coalition and Warren Rudman, and I think they had done a lot of good work as well. But those PAYGO rules and sequestration rules and so on were clearly part of the game plan that restrained spending that helped us get to that promised land of balanced budgets, but aided greatly, I think you would agree with me, by that surge of governmental revenues that came about because of the buoyant stock market and the high productivity and rising real wage rates. We had an awful lot of good things going on.

Mr. SPRATT. It was a convergence of all of those things. But if we hadn't had the budget disciplines in place, we wouldn't have taken maximum advantage. You wouldn't have seen the effect on the bottom line. But my question to you is the here and now, right now. If you want to see the renewal of those, shouldn't they apply to your tax cut proposal this year, your increase in Medicare benefits?

Secretary SNOW. No, I wouldn't. If you are asking me whether we should have offsets——

Mr. SPRATT. That is what the PAYGO rule means. If you don't have offsets——

Secretary SNOW. If you are asking me whether there ought to be offsets to the tax reductions, I would candidly say no, because if you do that, then you don't get the benefits of the tax reductions. And we need those tax reductions to put so many people back to work. I mean, it is 2 million people over the course of the next 3 years that get back to work because of this. And I think that is awfully important, too, to have—as we deal with international security, we deal with economic security at home.

Mr. SPRATT. Why propose it then, the renewal of the PAYGO rule, if it is not going to be applicable?

Secretary SNOW. The PAYGO rule should apply to spending.

Mr. SPRATT. Well, it does. That is what we are talking about.

Secretary SNOW. Well, I don't view a tax reduction as spending.

Mr. SPRATT. Well, it always applied to tax reduction and spending from the very beginning. So you are just talking about a PAYGO rule that has limited application. And would you apply it to your proposal, to, let us say, Medicare prescription drugs?

Secretary SNOW. No, I don't think we would.

Mr. SPRATT. That is spending, isn't it?

Secretary SNOW. It is a spending, but it is part of a larger program to reform a system that is badly in need of reform.

Mr. SPRATT. Well, I would agree with you about the need for prescription drug coverage, but you just proposed a rule, but then dispensed with all the applications of the rule.

Secretary SNOW. I am suggesting that we would defeat the very purpose of the tax reductions if we tried to offset the effect of the tax reductions.

Mr. SPRATT. I understand the point, but if you are going to make that point and make it in the manner you made it, then we shouldn't even be proposing in your budget that we have a PAYGO rule or—a renewal of the PAYGO rule.

Secretary SNOW. Well, I am talking about the PAYGO rules applying primarily to spending. I think we have to deal with the discretionary spending is where it applies.

Mr. SPRATT. The chairman touched on a very sensitive subject for anybody who operates in the realm of the budget, and that is the lateness and the reliability of early Treasury forecasts of revenues and the composition of revenues. And this is not a new topic; it has been around for a long time. We keep prodding and pushing the Treasury to come up with better estimating techniques so we can know far sooner than 18 months or 2 years what is the composition of income taxes, corporate taxes, whatever, in a particular fiscal year or calendar year. Do you have any plan for doing that—I know you have only been on the job for 2 days—improving those techniques?

Secretary SNOW. If I had a better way do it right now, I would tell you, but I don't.

Mr. SPRATT. Well, let me suggest to you the reason everyone bought into that fantastic forecast, $5.6 trillion in surpluses, was that it facilitated your tax cut proposal. We were warning that this was a blue sky estimate. You said you saw estimates of the economy slumping in August of 2000.

Secretary SNOW. Industrial sector.

Mr. SPRATT. Industrial sector. Transportation sector. The MBER says the recession started in March of 2001. The tax cuts weren't passed until June of 2001. So what happened is those who were pushing the tax cuts ignored the storm clouds that were gathering over the economy that people like John Snow at CSX were seeing; others were seeing them. They ignored those storm clouds and didn't want to acknowledge that that $5.6 trillion was probably an overestimate. Treasury and OMB now say it is an overestimate to the tune of $3.2 trillion due to economic adjustments alone. They didn't want to acknowledge that likelihood.

And here is what their budget looked like: If you designed a surplus, which excluded the Medicare surplus and the Social Security surplus; and those were the terms we were talking about on both sides of the aisle then, that we should stay out of both of those trust accounts. We were forswearing ever again borrowing and spending those surpluses. This is what the surplus would have looked like, and this is how it was applied in the budget that was adopted in the first year of the Bush administration.

And you see that top green sliver of a line, that layer at the very top? After the blue spending proposals and the green tax cuts, that was all that was left in the near term between 2002 and 2005, 2006 as a margin for error. And having made a very extravagant project—well, what turns out to be a blue sky projection of the economy and the surplus, they then came up with a budget that left no margin for error even though, as I said, storm clouds were gathering and people were questioning whether or not this surplus could indeed be obtained. That is what happened. And the reason you bought into it was because it made possible these tax cuts.

Now, at this point in time, if I could get the bridge chart—there we go. This is a little complicated for the screen, but this comes straight out of OMB numbers. This shows where the April 2001 surplus projection lay, $5.637 trillion. These are economic adjustments that OMB now says should be made to that. Those include technical as well as just economic growth adjustments. They don't break them down, unfortunately. That means the adjusted surplus that can really be expected to obtain in that period of time, 2002–11, the cumulative surplus is $2.463 trillion, and all of that virtually is Social Security. There is no on-budget surplus after that.

Then here are the enacted policies: tax cuts, the stimulus tax cuts, and then other enacted legislation, a large part of which goes to homeland defense and national security. The total of those enacted policies comes to $2.592 trillion. That means of the available surplus, adjusted available surplus, is already spent to the tune of $129 billion. That is the next item there. That shows you how much already has been spent. So, anything you do now goes dollar for dollar to the bottom line, adds dollar for dollar to the deficit, and, as the Concord Coalition said, that is a way of charging it up to our children. That is what it amounts to, shifting forward the burden of it. And the total amount of deficits that you are incurring is $2.122 trillion, and all of that—almost all of that results from policy decision making right now. You are saying it is OK to proceed from now because this is what OMB tells us. This is going to be the price tag of adopting this budget unless something falls out of the sky and gives us a higher rate than 3 percent, which is what they are assuming already, a pretty robust rate of growth for a 10-year period of time. Doesn't that give you concern?

Secretary SNOW. The—sure.

Mr. SPRATT. As a self-described deficit hawk, you are about to pursue policies that will increase the deficit by $2.122 trillion.

Secretary SNOW. Let us go back and talk about how we got there.

Mr. SPRATT. OK.

Secretary SNOW. The 2001 tax reduction was good policy. Who doesn't think that?

Mr. SPRATT. But that is over now. I am talking about——

Secretary SNOW. But it builds into these numbers.

Mr. SPRATT. I have got that in enacted policy. I am telling you, you are standing at the point with a cumulative deficit between 2002 and 2011 is $129 billion, and you are proposing to add $1.993 trillion to it, OMB numbers.

Secretary SNOW. OMB numbers that they will acknowledge, Congressman, understate the revenues for the future and build in all of the costs of the President's growth package. So they are worst-case sorts of numbers. I think the economy can grow faster, and it certainly will have more revenues in it than the numbers that OMB presented to you as they acknowledged, I think, that it was a pessimistic case on governmental revenues. So the picture is better than that.

Now, am I happy to have deficits of any amount? No. But as I said, deficits sometimes, regrettable as they are, are an essential part of carrying on the essential business of the country, the critical business of the country, homeland security now, and domestic security. And I think it is important to bear in mind the size of these deficits. These deficits are relatively small compared to the size of the economy and historic deficits coming out of recession, as is the debt level of the country. They are manageable, and they will be receding after a couple years. I think the OMB administrator had them going down, as was shown in one of these charts. They are deficits that we can work our way out of if we can grow this economy faster. And I would make the bet on growing the economy faster to work our way out while maintaining tight spending controls.

Mr. SPRATT. But you will admit you have got fairly robust growth built into this budget already. It is better than 3-percent real growth for the next 10 years, averaging out over 10 years better than 3-percent robust growth, real growth.

Secretary SNOW. I will have to check that to confirm that you are right. If you are, I will certainly acknowledge it. I had thought that OMB had explicitly not taken into account the growth effects, or had discounted some of the growth effects of the President's package, but had scored the entire cost of that package.

Mr. SPRATT. Let me just ask you a final question. I don't want to monopolize this, but this is a very important part of the decisions that lie ahead of us. This is our back of the envelope tab of what is on the agenda, the Bush administration's tax cut agenda.

The first couple of items are done deals. They are enacted law. The tax cut of June 2001, the cost of it a $1.349 trillion without including any additional debt service. The stimulus package in March of 2002, $42 billion. And now you've got on the table a growth package, a small portion of which has been passed, a so-called growth package. It will be implemented over a period of time. The cost between now and 2013 is $615 trillion. That is an OMB number. You are also proposing making permanent the 2001 tax cuts, which cost about $692 billion.

As I said, I think you have to include the alternative minimum tax. The Treasury was the first to blow the whistle on the alternative minimum tax. They put out a report a couple of years ago and said, given current trends the number of tax filers who will be confronting the AMT will grow from 2 million to 39 million over the next 10 to 12 years. I have forgotten the time frame. The numbers are roughly correct. You know and I know politically we will have to deal with it, and equitably we should deal with it, because when we pay off the alternative minimum tax it was a way of saying to upper bracket taxpayers you are not going to be able to wipe out all your income tax liability with reductions and credits and preferences and so forth. You got to pay at least the minimum tax. We never meant for that to apply to middle income taxpayers, but it soon will. But the number who have to confront the AMT every year grows from 2 million to 10 million. Politically, the pressure for doing something about it has to be dealt with. You said that for several years, your Treasury Department has, both administrations. The AMT has to be confronted, the committee deals with it. Don't you agree it has to be included? If you talk about this time frame, we are talking 2004–13, and you don't include the AMT, you are fooling yourselves and you are fooling the American people.

Secretary SNOW. I think it will be addressed but it should be addressed by the Congress and the administration as part of an overall tax reform package rather than as a one-off item.

Mr. SPRATT. What you are saying though it has to be offset, is that what you are saying? That would mean revenue increases somewhere.

Secretary SNOW. It is an issue that needs to be addressed. I am granting you that. How and when is something I really don't have an opinion on at this time.

Mr. SPRATT. Between now and 2013, the taxpayers affected by it will grow from 2 million to 24 million. Don't you think before 2013 within the time frame we are talking about, well, within it, you have to deal with this issue; therefore it has to be included in the tally of the tax cuts likely?

Secretary SNOW. But I think it should be addressed in the larger context of real, broad tax reform.

Mr. SPRATT. Let me ask you one final question. It is time to clean the closet out. We need to scrub the code down as we did in 1986. It is long past due. And one of the anomalies in the code we could deal with in a tax reform package would be the taxation of dividends. Why not put it in a revenue neutral tax reform package? And indeed why not make it for the corporate Tax Code the big chip just as the ITC and accelerated depreciation was. It was a trade-off to get lower rates. Why not play this chip and say to corporate America we will give you this if you will agree to get rid of these loopholes and the exclusions that lower the effective rate of corporate taxes from 35 percent to 15 percent? Aren't you passing up a real opportunity there to induce real change and a good cleaning out of the corporate Tax Code?

Secretary SNOW. There are a variety of ways to do things. However you look at this proposal, it is just good economics.

Mr. SPRATT. But it is not good bargaining. Put it on the table and corporate Americans say this is what we will give you if you will agree to get rid of these loopholes and these things that let you expatriate and locate in Bermuda and avoid taxes. This is the incentive to you. We are going to handle the double taxation dividends problem in return for your concession on these issues.

Secretary SNOW. There are a number of advantages from the exclusion on the dividends, one of which is it reduces the incentive to do the very thing that you find objectionable and I find objectionable, inversions and tax shelters, abuse of tax shelters and things, because if you are not paying income tax on it there is nothing to shelter.

Mr. SPRATT. You have to have something to show.

Secretary SNOW. There is a byplay here between the dividend exclusion and encouraging good taxpayer behavior.

Mr. SPRATT. I agree, and put them in the same package and you got something you can pass. Thank you, sir.

Secretary SNOW. Let me close though. I think you and I maybe didn't agree on everything there, but I think we can agree on the need for better estimates and I will go to work on that.

Mr. SPRATT. I would hope we found broader common ground than that.

Chairman NUSSLE. Just to complete the record, I was curious, is the proposal offered by the Democrats compliant with PAYGO and offset and revenue neutral?

Mr. SPRATT. If you are not going to play by the rule, we are not going to play by the rule.

Chairman NUSSLE. Just wanted to make sure the record was complete.

Mr. Gutknecht.

Mr. GUTKNECHT. Thank you, Mr. Chairman. Mr. Snow, we welcome you to the committee and to Washington again. The first question I have for you, are you a volunteer or a conscript? I suspect you are somewhere in between. You don't have to answer that question. You know it bothers me sometimes when they take words that I used back in 1995 and throw back at me today. Things have changed. And clearly the economy is different today than it was in 1995 and the circumstance we find ourselves in is different than it was in 1995.

I do want to agree with you on everything that has been said. As we look at projecting what the economy is going to do, what revenues we are going to produce, we can agree now that this is a very humbling business. But I do want to come back to some things because I didn't hear the kind of answers that I think ultimately the American people want to hear. The chairman asked a pretty interesting question. Why don't we just freeze everything? I mean most Americans would be happy if the Federal Government would just freeze an awful lot of the spending and allow the economy to catch up.

Let me give you an example. And we sort of have this debate sometimes between CBO and OMB and what Alan Greenspan says and other people say about where the economy is and where it is going, but according to our official bean counters at the Congressional Budget Office this year the Federal Government will increase revenues to the tune of 3.7 percent. Now yesterday Mr. Daniels was here and I await a little better explanation because in many respects I was proud of the fact that he stole a line from me that the Federal budget shouldn't grow any faster than the average family budget. But the average family budget is not growing at 4.5 percent, at least by my estimate. And I want to come back to this point. If revenues are going to increase by 3.7 percent this year and the Bureau of Labor Statistics tells us that the CPI is going to increase at 1.8 percent, that is about half, I guess on behalf of an awful lot of Americans, why isn't 3.7 percent enough for the Federal Government?

Secretary SNOW. Well, Congressman, I am fairly new in this job and didn't have too much to do with preparing the budget for the United States, but I think the short answer—and it is a question better addressed to Mitch Daniels than to me, but I think the short answer is that there are pressing national priorities. There is the priority of homeland security, which takes a very significant part of that increase in the budget expenditures for next year. There are also initiatives in a number of other areas, the prescription drug proposal that I think enjoys widespread support, is part of a broad Medicare reform program that makes sense.

There is a cost to not doing things as well as a cost to doing things. If we don't do a growth package like this, what do we tell the 2 million people who don't have jobs who otherwise would have had jobs because of the growth package? How do we explain that we failed to take the action that makes the economy stronger? The action you all took in and the Congress took in 2001 was an essential action. It cost. It certainly had—scoring it, it produced more deficit than it produced revenues, but it was good policy. And I think if we keep focused on doing good policy, and then asking ourselves what is the opportunity cost, what do we give up because we don't do it and then look at what shouldn't we do. Should we not maintain the homeland security? Should we not wage the war on terrorism? Should we not try to put 2 million people back to work? Should we not take the growth up a percentage point over where it is otherwise? I think the foregone alternatives of not doing these thing are actually greater than the costs of incurring the budgetary impact of doing them.

Mr. GUTKNECHT. I agree with you generally that allowing people to keep more what they earn during times when the economy is soft is really a good thing to do. My concern is on the spending side. You said there is broad based support for this program. You will find here in Washington there is broad based support for virtually every spending program. It is the responsibility of this committee to try and restrain that spending so we can actually have a balanced budget and ultimately create room for additional tax relief.

The problem I have with the budget that the White House sent up is they say "yes" to almost every one of these priorities and you come back to the basic number. To a lot of Americans allowing the Federal Government to have a growth in their revenue of 3.7 percent ought to be enough to fund the legitimate needs of the American people. And at some point I think we all have to come to grips with the tough decisions we have to make, and we need some help from folks like you to get that done.

Thank you.

Chairman NUSSLE. Mr. Moran?

Mr. MORAN. Thank you, Mr. Chairman. You know, this is exactly what President Bush the first called "voodoo economics." It is Reagan redux. Some of us remember in 1980 when David Stockman spun us the same kind of pitch. Deep tax cuts for the wealthiest taxpayers, dramatic increases in defense spending, which the Democrats didn't oppose, and then of course what the Democrats label as Draconian cuts in social programs, which they felt was part of the long-term agenda. When President Bush the first came into office and there was some resonance of his description of it as "voodoo economics" because it didn't pan out, and it quadrupled the Federal debt in just 8 years. In 1990 he put together a bipartisan budget summit, raised taxes marginally on the top rates and balanced the budget. President Clinton followed up with a balanced budget and raised taxes on the highest taxpayers, who, incidentally, including yourself, over the last 8 years have taken back more after tax income than at any time in American history, so it obviously didn't hurt, but it balanced the budget. And so it left us with a $5.6 trillion surplus at the beginning of 2001. And that was the justification that we were given for the deep tax cuts of 2001. And we were even told and I remember, in fact the chairman suggested it, that the growth could well be more than this, that—the suggestion was we really didn't need to worry about surpluses and what the loss of revenue would do because the economy was going to keep growing. And so we left very little margin for error. And now you are telling us, as we have been told five times now, that this budget is going to grow the economy. In February of 2001, we were told that this budget will grow the economy. We were told again in the mid-session review in July of 2001. Again in February of 2002. Again in July of 2002. The same spin. And yet we have had the worst job growth in 58 years. We have had the worst economic growth in 50 years. It is the worst first 2 years of any presidency from an economic perspective. And yet you are telling us, well, we really shouldn't worry much about the fact that we have got deficits as far as the eye can see because economic growth is going to be better than what you suggest.

And yet we look at the analysis that OMB has given us, your economic growth figures are more favorable than CBO's or the Blue Chip forecast. Your unemployment rate is less than CBO or the Blue Chip forecast. The interest rates that you say you would pay are lower than CBO or the Blue Chip forecast, and yet you think you can tell us these numbers, give us this Pollyannish projection and, you know, everything is going to be OK.

The worst aspect of this whole economic plan is that you are cutting taxes in every way possible on unearned income at the expense of earned income. In other words, the people who are paying for the $4.4 trillion of tax cuts, including interest costs over the next 10 years, the people who are paying for that are the ones who are payroll taxes into Social Security, FICA taxes, because you are taking $2.2 trillion out of that Social Security money and using that to offset the cost of the tax cuts. So you take it from those who can most afford it and take it—and eliminate tax on those who can most afford paying them and then sticking those who can least afford it. That is our biggest problem with it.

And you know, in fact, Mr. Nussle used the expression our problem is a lack of confidence that people are not investing, they are waiting because of the uncertainty. You said it triggers their confidence. I agree with you, the stock market has lost $5 trillion since your President took office and it is primarily a lack of confidence. So if you have any response, I would be interested in hearing it, Mr. Snow.

Secretary SNOW. Congressman, I hardly know where to begin, but let me take on a few of your points. You are right, the economy—the Nation has been subject to a deep and far reaching set of shocks that help explain the situation we are in today, not the least of which is the extraordinary meltdown of the Nasdaq and the equity markets generally. I think it is actually $7 trillion that has evaporated with gigantic wealth effects.

Mr. MORAN. I didn't want to exaggerate.

Secretary SNOW. That is probably over the whole period. Then the recession, then 9/11, then the corporate scandals, crisis of confidence in corporate leadership, on and on. We have had a set of shocks, a series of shocks to the economy that are of far reaching proportions, and yet the economy remains resilient. It is really a credit to the strength of this economy and to past policies that the economy could respond as well as it did. I will come see you some time and talk about the numbers.

The Blue Chip estimates actually are for more robust growth rates than the growth rates that the administration has and for lower unemployment. Well, I won't read it to you, but I have it here. For instance, in 2003 the administration unemployment rate is—well, I won't read all these to you because it will take up too much time. On the issue of fairness, because we always come back to this issue of fairness, I think it is important to come back to the fact that the burden of the Government, the burden of the revenues is higher on the top taxpayers after this proposal than it is before that proposal; that is, if you enact, if the Congress enacts this proposal, the highest income taxpayers will be paying a larger share of the total obligations of the Federal Government than they do before, and the lowest income taxpayers will be paying a lower share of the total obligations of the Federal Government.

Mr. MORAN. Is that after estate taxes?

Chairman NUSSLE. The gentleman's time has expired. Mr. Toomey.

Mr. TOOMEY. Thank you very much, Mr. Chairman, and, Mr. Snow, welcome to the committee. I can't quite see you there but I know you are there. I want to comment briefly and follow up on a comment one of my colleagues just made that we are looking at Reagan redux, and all I can say is I just vigorously hope he is right. It is amazing to me. When Ronald Reagan came to office and dramatically slashed taxes, especially marginal income, including taxes on the highest wage earners in our country and because he dramatically increased the incentives to work and save and invest, he ushered in a 17 year long economic boom that has created more wealth, prosperity and opportunity than this country or any country on the face of the Earth has ever seen. How anybody can look at that and say that was a bad thing is fascinating to me. It is baffling to me. It was a wonderful thing, and it was driven primarily by dramatic reductions in taxes.

There is another aspect of this debate which is almost a little overwhelming to me, and that is that the same folks who are so concerned about the size of the deficits are the very same folks who want to spend even more money. We have had huge increases in spending in recent years. And my good friends on the other side—and I don't doubt their sincerity about their concerns with the deficits, but the fact is they are only going to get worse if we keep the spending going.

The President proposed a budget which is a refreshing change from the previous administration in that he is trying to hold the line on spending. I hope we can do more. I am going to work to try to reduce spending below the level the President has proposed. But I understand in Congress that is going to be really tough to do. So if we end up right where the President is, we need to take that as the given, that level of spending, high in my judgment but maybe that is where we end up, the question then I think becomes which is better for the economy, to finance that as the President has proposed, almost entirely with taxes, but with a little bit, about 2.7 percent of our economy with debt, or should we instead raise taxes and finance the rest of it also by taking money away from the wage earners of America and doing it all with taxes instead of this combination? I think that is the question before us.

We will wrestle with the spending level. We will probably end up somewhere around where the President is. And I would just ask you to comment on which is better for the prosperity of America, for the economy of our country, for job prospects to just raise taxes and finance it all with taxes or to have this modest component of debt?

Secretary SNOW. You framed the essential issue here, Congressman, better than I did. It is that notion of opportunity cost. What do we give up if we don't give the taxpayers more of their own money? And on the other hand, what does it cost us in real terms if we try to finance it through tax increases. I think framed that way there is only one answer you can come to; it is clearly better to go down the path the President is taking us. Sure, we have a little higher debt, still debt that is in the really modest range by comparison with the past, 2.5 percent, 2.7, coming down well below that in the years ahead.

The other side of this is who would propose a tax increase to accomplish that objective. I don't think you would, and I don't think you would get the objective. You would have lower employment and lower growth and ultimately less Federal Government revenues.

Mr. TOOMEY. I agree. As to the question of the total amount of public debt—and I would love to see us have a balanced budget this year. I think you have been quite right in framing this as plausible alternatives right now, but could you just comment on—we are running about low 30s as a percentage—our debt as a percentage of GDP in America. Of course that is not including the unfunded commitments of the major entitlement programs, which obviously require profound reform, but where do we rank amongst major industrialized nations? What statistics could you share with us to put that in context?

Secretary SNOW. Maybe we could put up a chart that would be helpful on the overall question of the Federal debt held by the public. I don't have offhand, maybe somebody here does, our debt versus other countries. I think our debt is significantly lower than the debt as a percent of GDP by most OECD countries. But what this chart shows, of course, is that the debt that is projected out for the years ahead is lower than the debt we have experienced in most of the period since the 1980s. It is a manageable level of debt. Would it be better if we could have it lower? Absolutely yes. But could we accomplish the national objectives without this level of debt? I don't think we could either.

Mr. TOOMEY. Thank you, and a last quick question. I think the President's proposal for a new round of tax relief is vitally important for both the short-term and even more importantly for the long-term sustainable growth. It seems to me capital formation is a critical component in maximizing—long-term maximizing sustainable growth. Do you believe that is correct and the double taxation on dividend—eliminating that double taxation on dividend absolutely has to have a strong positive effect on capital formation?

Secretary SNOW. I think there are a few who would dispute that. Even those who wouldn't favor the proposal would acknowledge that the double taxation of dividends hurts our national capital formation. As I said earlier, anything you tax more of, you get less of. And we are taxing capital formation, equity capital formation and encouraging overuse of debt as a consequence. The marketplace left to itself would use more debt—less debt and more equity. Because of the Tax Code we have higher debt to equity ratios than we otherwise would have. And that is not a good thing for the economy. What sense does it make to penalize equity capital formation? What sense does it make to discourage corporations paying out dividends to their shareholders. I have sat in on any number of meetings where senior management and the board thinks about how to reward shareholders. They say what can we do here. Well, you can buy somebody because you can use debt to buy somebody. You can buy in your shares. You can use debt to buy in your shares. That is tax deductible. You can make some internal investments or you can pay out dividends. What is the conclusion most companies come to? That is a tax inefficient way to reward our shareholders, so we do less of it. By leveling the playing field on dividends, we are going to do something that is important for corporate governance. One of the charges today, one of the concerns today in the capital markets is how accurate are these numbers. Are the numbers being managed? You can't manage cash. Once we are paying out more cash dividends, the best possible way to show shareholders what your real earning power is and I think by eliminating the double taxation, we are going to see many companies, like Microsoft announced recently, will begin paying dividends.

Mr. TOOMEY. Thank you.

Chairman NUSSLE. Mr. Neal.

Mr. NEAL. Thank you very much, Mr. Chairman. Mr. Secretary, for the last two sessions of Congress, I have filed legislation on corporate inversions. I think in the last session there were 187 signatures on a discharge petition, and it deals primarily with the issue of those companies who move to Bermuda for the purpose of avoiding U.S. Corporate taxes. Do you think that in a time of potential war and deficits that it is patriotic for these companies to move to Bermuda for the purpose only and solely for avoiding American corporate taxes?

Secretary SNOW. Well, if you are asking me whether I am a fan of inversions, the answer is no.

Mr. NEAL. Do you think we should do something about it?

Secretary SNOW. I understand the department has a number of studies underway on that subject. I think it is a subject that needs to be looked at. The Tax Code certainly shouldn't be inducing abusive tax avoidance behavior. And I don't know enough about the subject, as you do.

Mr. NEAL. Let me help you. Mr. Secretary, I have been on the Ways and Means Committee for more than a decade and I have heard the chairman of the Ways and Means Committee—and since some of us here suffer from amnesia, let me use a reminder—I have heard prominent members of the Ways and Means Committee say that upon their watch they were going to pull the Tax Code up by its roots. And then I heard we were going to dismantle the tax system. And I heard the former majority leader talk all the time about moving toward a new tax system. And I heard candidates for President say we are going to a long funeral procession for the Tax Code.

Do you really believe in the next couple of years you are going to change the Tax Code here, Mr. Secretary?

Secretary SNOW. I hope we improve it some.

Mr. NEAL. Do you think we are going to move to a flat tax or a consumption tax in the next couple of years?

Secretary SNOW. I don't know. You and the Members of the Congress would probably have a better sense of that than I. But I think the proposal, the President's tax proposal certainly produces a better tax system, a simpler tax system. If you tax something only once, it is a lot simpler than if you tax it twice.

Mr. NEAL. Well, for these guys in Bermuda, there is no tax at all.

Secretary SNOW. But they move there because they are trying to avoid taxes, and if you don't tax the dividends, you remove the reason for them to go abroad. If people don't have to pay taxes, then they don't seek shelters.

Mr. NEAL. What do you think the IRS would do to individual taxpayers if they moved to Bermuda for the purpose of avoiding taxes?

Secretary SNOW. I don't know.

Mr. NEAL. We could save $4 billion, Mr. Secretary, by just asking these folks to pay their share. Business people applauded me at a Chamber of Commerce luncheon last week with 1,200 people in the audience when I said when these folks don't pay, you pay more. Not a bad applause line for business people. They understand it. The American people understand fairness in the tax system. You answered earlier saying we should always come back to fairness. Not a bad position to start from, never mind to come back to.

Finally Mr. Secretary, what kind of job do you think Secretary Rubin did during his years in the Clinton administration?

Secretary SNOW. I am an admirer.

Mr. NEAL. Do you think he was more right than wrong in the suggestions he made?

Secretary SNOW. Tell me which particular suggestion you have in mind.

Mr. NEAL. Suggesting that we pay down deficits.

Secretary SNOW. I wish Bob Rubin had become more a champion of tax reductions. I talked to him about that and I never could persuade him of the benefits of some lower marginal tax rates.

Mr. NEAL. The problem I hear is the former majority leader said when we passed those three budgets, which I voted for with Bush Sr. and Clinton twice, I remember the former majority leader saying that we were headed to fiscal Armageddon. And then I heard the former chairman of the Budget Committee say that we were headed toward the greatest depression in the history of the country. Now I hear Rubinomics is dead after we proceeded on a course of success that is unparalleled in American history. Would you agree with that in terms of economic prosperity during those 6 years?

Secretary SNOW. I take my hat off to everybody who had a hand in bringing about the balanced budget in that period. My preference, though, would have been to see it done with a little different mix of tax increases and spending reductions; in other words, less on the tax increase side and more on the spending restraint side.

Mr. NEAL. I think my time is up, Mr. Chairman.

Chairman NUSSLE. Mr. Hastings.

Mr. HASTINGS. Again, if I could ask my friend from Alabama to lean back and my friend from Arizona. Mr. Secretary, I want to congratulate you for being here and having been on the Hill. The chairman alluded to that when you have only been on the job for a couple of days. You have been inundated with a lot of things. I know that you haven't had an opportunity to really look at very closely and I congratulate you coming up here and really taking the heat.

Couple of comments on the data that you have been thrown at, and you did respond to Mr. Spratt that there is probably agreement between the two of you on the one issue that you try and do. Projecting ahead is a very inexact science and you are being inundated to comment on things that will happen 11 years from now. And we know we will probably be way off—pick a factor. I am sure that will happen. But let me pick up on a very basic issue as to where the policies that are being suggested by this administration and past policies by prior administrations. If the idea of having—in fact for many years, the idea of trying to get the economy going is to have some sort of Government stimulus, infrastructure and so forth. If that were the case and the fact that the Government is spending, we should never be in a recession if that were a very accurate model, it seems to me. What you are doing is—and the President is doing is—let us trust the people more by giving them more of their money.

So my very basic question to you is, does the economy tend to perform better when there is more government intervention or less government intervention? And based on whatever your answer is—and I hope it is B—tell me why that is the case and why we should be looking at that long term.

Secretary SNOW. Well, I think there is clearly a role for government in a lot of spheres. But there is also no doubt about the fact that the reduction in the role of government over the last 30 years or so—less transportation regulation is one example and deregulation in many, many spheres—has been a big boost to the economy. And I am a big believer in minimizing—maximizing the role of the private sector. I think the strength of this country of ours and the strength of this economy is that we really give a large role to the private sector. We let the private sector work. We let markets work and we contrast the performance in the United States with the performance, say, in Europe. And the defining difference is the fact that we believe in markets. We let labor markets work. We let capital markets work. And we have embraced market principles here, whether in the international trade arena with trade liberalization or in domestic markets, in banking and finance with Gramm-Leach-Bliley, on and on and on. We have made this economy much more responsive, much more competitive and much more efficient. As we do that, we grow more. We create more good jobs—not just more jobs, but more good jobs, more jobs with rising real wage rates.

So I am a very strong believer in the competitive marketplace and letting the competitive marketplace operate. Clearly there has to be rules, but letting the competitive marketplace be the driver of economic performance and making that bet on peoples' initiative and spending their own money and making their own decisions and responding to the forces of the competitive marketplace, which disciplines all of us, I think is the surest and safest course for rising outputs and higher standards of living. I agree with you 100 percent.

Mr. HASTINGS. Mr. Secretary, thank you very much for that response. I was fascinated when Milton Friedman essentially wrote a book or a thesis on how a pencil is made. I mean the dynamics in the marketplace is absolutely incredible. And where we are trying to go is to make that obviously more of a long-term phenomenon than a short-term phenomenon. So I give you a great deal of credit for taking that initiative. But more than that, once again, I think you do a wonderful service coming up here with only 2 days on the job and taking what you are taking.

Secretary SNOW. Mr. Chairman, if I could expand on the Congressman's point for just a minute. In the 1970s, I had the privilege of serving in the Ford administration in a role where my responsibility was to develop the transportation policy initiatives heading the policy shop over at DOT under Secretary Bill Coleman, and we worked with the best economists in the world, best at quantifying market impacts and so on, and we developed these proposals. We didn't get them through. They were enacted when President Carter and his administration picked them up and moved them forward and ran with them and got a congressional blessing on them.

None of us, none of us who were doing the forecasts on the economic gains from eliminating truck and rail regulation had any idea how much the wealth effects would be, how gigantic and huge the savings for the economy as a whole would be. None of us forecasted the fact that in the railroad transportation business, transportation rates today in real terms are 40-percent lower than they were back then. In the trucking industry it is also 40-percent lower in real terms, and with better service and with greater profitability. What happened there, we unleashed the marketplace, and when we unleash the marketplace all sort of wonderful and unforeseen things happen.

I think that is going to happen with the President's dividend proposal. That is why I so strongly support it.

Chairman NUSSLE. Mr. Edwards.

Mr. EDWARDS. Thank you, Mr. Chairman. I would like to address two reasonable questions raised by a Republican colleague in this committee. One is, does the economy perform better or worse with more or less government intervention? And I would suggest Enron is an example where the company would have fared a heck of a lot better and millions more might be employed today if we had more government intervention rather than less. I don't believe the sound bite that the least government is always the best government. And I say that as someone who is a great defender of our private market system.

Second question raised by our colleague from Pennsylvania, and I think this gets to the root of the difference here about this year's debate between Republicans and Democrats. He said how can anyone disagree with the Reagan fiscal policies of the 1980s. I am one person who does disagree with those policies because they led to the tripling of our national debt in less than a decade, and perhaps that is not a concern to some members of this committee. It should be a great concern because it will be a huge burden to our children and grandchildren, and there is nothing economically sound, there is nothing fair about paying for today's tax cuts by charging the cost of those to our children and grandchildren.

Now, Mr. Secretary, what I am hearing this administration saying is several things regarding the budget. First, when the economy is good and we have surpluses, let us cut taxes and give that money back, thus ignoring the fact, the reality we already have a $6 trillion national debt. Well, then when the economy turns around and is bad, let us have tax cuts to stimulate the economy. Tax cuts under any situation may be good politics, but I think it is irresponsible policy. And if I were an American businessman listening to this debate today, I think what would concern me more than the fact that we are having to face the largest deficit in the history of America is that former Republican budget hawks are now rationalizing and explaining away the significance of having the largest deficit in the history of America.

And the next thing I hear this administration saying is this budget deficit is moderate and manageable. It may be moderate compared to the next worst case in the history of the United States, 1992, but I don't consider a $300 billion deficit this year and, even more importantly, deficits as far as the eye can see to be moderate or manageable. The impact upon our children will be devastating when they have to pay the debt tax, the interest on the national debt. The impact on businesses when this economy starts back up again and we have higher interest rates because of huge deficits will inhibit growth, not help growth.

Third thing, this administration says this budget is a growth budget. I would challenge this administration to show me in the history of the world any nation that took the philosophy that long-term deficit spending is a growth stimulator. There is no evidence of that throughout the history of the country. And I believe this is a growth inhibiting budget because it endorses massive national deficits for years to come.

Next, I am hearing we are not responsible for the largest deficit in the history of the United States. Obviously, you are not responsible for the war against terrorism or the attacks on this country. We all understand that. But you are responsible for proposing $2.8 trillion in tax cuts while we face these problems and know we have to pay for these problems. The fact is we would not have the largest deficit in the history of the United States today had it not been for the $1.3 trillion tax cut that some of us did predict 2 years ago would lead to deficit spending.

Finally, I hear you talk about cutting spending. Yet the six largest programs of the Federal Government that represents 74 percent of spending are Social Security, defense, Medicare/Medicaid and health, interest on the debt, education and training. This administration and this budget is proposing increases in three of the six largest programs. The fourth we have no choice. We must pay the interest on the debt. That leaves Social Security and Medicaid.

Mr. Secretary are you proposing cuts in those two programs?

Secretary SNOW. Congressman, thank you for those good questions. First of all, on the issue of the manageability of the debt load, clearly as Mitch Daniels said to you, we are in a deficit position and we will be for some years to come. But the green line there shows that those deficits are relatively moderate compared with past periods as a percent of GDP and that they are shrinking as a percent of GDP and are well within what is manageable. I think the important thing about a deficit—and you raise a good question. We have to keep that question in mind always. But the important thing about a deficit is does it influence the way financial markets react and respond, because if it influences the way financial markets react and respond then we will get higher interest rates. And financial markets react and respond if they think the deficit is large and growing relative to GDP or the debt is large and growing relative to GDP and if they think it is going to be sustained. I think financial markets are accepting these deficits that are projected. I think they are bigger than they are going to be, frankly, for the reasons I went through earlier. But the important thing is to make sure that they shrink over time and stay modest, shrink both in absolute and in relative terms.

And of course we are now living in a period where financial markets reacts instantaneously to the information they have available to them. They have this information. They have seen this coming. And interest rates I think are the lowest in 40 years. So while I very much share your concern about deficits, I will come back to the point that the level that we are at today is manageable and is not an undue burden.

Chairman NUSSLE. Gentleman's time has expired. Mr. Brown.

Mr. BROWN. Thank you, Mr. Chairman. Thank you for coming. You have only been on the job a couple of days but you are not short of advice, and we appreciate you coming today and letting us kind of pick you a little bit. But we debated the tax cuts and we recognized that the economy was in a downturn and the highest tax level was over 39 percent we felt it was too much and lowered those rates down to 35 percent. We felt like the death tax was unfair and we eliminated that and now propose eliminating the double taxation on dividends and the unfair tax, the marriage penalty. All of those were issues we felt were relative issues that needed to be adjusted. And yet we find in the economy, we look at the long range plan of over 5-percent unemployment over the next several years. Those issues must be addressed. The economy has got to be put back on the right track. We appreciate your efforts to help us mend that.

Are there any viable alternatives you see—suggestions from the other side—other than to cut the tax at the lowest level? And you know with this tax rate, you have already expanded that. Balancing the budget using the Social Security proceeds, there has been a lot of debate about how to do that and whether they are going to have a locked box exactly—how we intend to do it. But under the code itself, the only investments we can have in the Social Security proceeds are in Federal instruments. So how do we separate that? I don't think we can take the Social Security proceeds and just put it in a locked box and not gain any kind of a return.

Would you explain on how that might work?

Secretary SNOW. I am trying to understand how a locked box would work and what the concept of a locked box really is. Social Security is a pay-as-you-go system, and it is a system with intergenerational obligations. It is currently running a surplus. We know that that surplus will run out at some point in the future. Every dollar—every penny of that surplus is credited to the trust fund and is backed by the full faith and credit of the United States. So there is no taking away, there is no—I hear this term from time-to-time, raiding the trust fund. That is a misuse of the language. There is no raiding of the trust fund. To create a locked box without a return, as long as it is cash you put into it, seems to me that would be sort of a far-fetched notion. That wouldn't make any sense. The only reason why it would make any sense out of the notion of a locked, box and you can help me understand this better, is that you take the money and pay down the debt. But the reason that deficits are going up is that we have these urgent national needs like putting people back to work, as you alluded to, and getting the economy growing. So going that way wouldn't seem to make much sense. And I am puzzled by just what the locked box concept means in this context where the only way I can make any economic sense out of the idea of a locked box is that you use it to pay down the debt. And if you do that, then we aren't accomplishing these important objectives.

I hope that is responsive.

Chairman NUSSLE. Mr. Scott.

Mr. SCOTT. Thank you. Mr. Snow, welcome. It is a pleasure to see you here and I hope you bring some Virginia fiscal responsibility to this administration. Now I know this budget isn't your fault, but it is the President's budget that you are having to defend. One of the things you mentioned was growing our way out of it. And I just wanted to get the record straight. Is it not true that the OMB figures for real growth, inflation, unemployment and interest rates for the future are more favorable than CBO and the Blue Chip consensus? And if you don't know——

Secretary SNOW. I don't know, but I will check the record for you. I had thought that there were a number of private forecasters that had more robust growth and lower unemployment.

[The information referred to follows:]

MR. SNOW'S RESPONSE TO MR. SCOTT'S QUESTION REGARDING OMB FIGURES

Of course, there are some slight differences among the different forecasts. The administration's budget forecast is finalized in late November to early December, in order to have time to develop budget numbers that correspond to the economic figures. CBO and Blue Chip figures were assembled a month or two later and therefore are based on somewhat more information. Even so, there is really remarkable similarity in the results.

Over the 6 years of the forecast period, the administration estimated real GDP growth to average 3.3 percent, only a shade higher than the 3.2 percent contained in the CBO and Blue Chip forecasts.

The 5.3 percent average unemployment rate forecast by the administration for the 6 years matches the Blue Chip. CBO estimates 5.5 percent.

The administration's view of inflation does show slower growth—an average of 1.6 percent over the 6-year forecast horizon for the GDP price index, compared to 2.0 percent in the other two forecasts. CPI growth is estimated at 2.2 percent by the administration and 2.4 percent by the CBO and Blue Chip.

Slower inflation means that the administration projects slower growth of nominal GDP than in the other two forecasts—a rate of 4.9 percent compared to 5.2 percent (the sum of real GDP growth and growth of the GDP price index). This would work against the administration's budget forecasts since lower nominal GDP would result in lower tax receipts.

Even after accounting for slower growth of indexed programs, which are based on the CPI, the budget impact narrows but the Blue Chip and CBO figures would still be slightly more favorable for budget estimates.

Overall, while we can point to modest differences among the forecasts, it seems that all are very much within a narrow range.

Mr. SCOTT. My reading of the President's budget shows it is more favorable in each of those categories. One of the things we mentioned as a recovery—unfortunately this budget doesn't have much help for the recovery. The things that will help the recovery are the short-term expenditures, especially the cheap ones like accelerated depreciation which, long term, don't adversely affect the budget very much but have a stimulative effect now or temporary increase in unemployment benefits that don't lock in payments but give you the benefit right now. The backloaded tax cuts will have nothing to do with stimulating the economy now.

Can I get chart No. 5? You have seen this chart several times. It reflects the tough choices that were made in 1993. They were unpopular, but they were responsible. And as a direct result of the votes that Democrats cast in 1993 that put us on that trajectory, the Republicans campaigned against us and took 50 seats. Now that green line right there is not an accident. It is in stark contrast to the projections in chart No. 3, which show that we are just spending Medicare, Medicaid—excuse me, Medicare, Social Security and then some as far as you can see. You are from Virginia, Mr. Snow, and you have seen the kind of work that Mark Warner has done and the responsible decisions he has made, and that is in stark contrast to what we heard yesterday when Mr. Daniels came and suggested that there is virtually no problem and he intends to make none of the tough choices.

Could we have No. 14? Now, you indicated that this thing the deficit is manageable. I would like to ask you how we can manage—this stops at 2008. That is when the baby boomers start retiring in Social Security. With the substantial new taxes that have to be paid—not to pay down the debt but just to carry the debt. There is nothing in there for the war on Iraq. How are we going to be able to manage the Social Security and Medicare challenges of the baby boomers?

Secretary SNOW. Congressman, thank you. Again, you are raising the right questions and the important questions. The way we manage those obligations to the future is to have a well performing economy and to have a bigger economy and to get the growth rates in the economy that will give us the flexibility to respond to those needs. I am troubled, as you are, by the long-term financial status and sustainability of Social Security and Medicare. The issues are a little bit different, but demographics drive both and of course rising health care costs particularly drives——

Mr. SCOTT. Do you acknowledge that as the thing gets worse, in terms of this budget it gets worse at a time when we need to be in a fiscal position to meet the biggest fiscal challenge America has ever seen, baby boomers retiring?

Secretary SNOW. We need to be benefited by the strongest possible economy as well.

Mr. SCOTT. So do I understand you to say that we are going to hope we grow out of it without any contingency plan?

Secretary SNOW. No. I wouldn't hope; I would pass this legislation so we do.

Mr. SCOTT. Well, we see which direction we are going in, as far as I can see.

Let me ask you another question. Do you believe the AMT needs to be fixed if we go from 2 million to 39 million Americans paying the AMT?

Secretary SNOW. As I commented earlier in response to that question, it is an issue that clearly has to be addressed. I am not close enough to the facts yet to know how best to address it or what the time frame is.

Mr. SCOTT. There are only a number of ways to fix it; that is, you can increase taxes, spending cuts, or increase debt.

Secretary SNOW. Or you can make it part of a broad-based tax reform proposal.

Mr. SCOTT. Which would increase taxes or reduce spending or increase debt.

Secretary SNOW. Or grow the economy significantly faster than it would otherwise grow. I mean, I still think this code is a burden on the economy. I don't want to shrink from coming forward on this, on that proposition, and I think lower marginal tax rates make good economic sense.

Mr. SCOTT. Thank you, Mr. Chairman. And I would just like to point out that this budget has very favorable growth already in it, and in spite of that we are seeing, the numbers go south at a rate that we haven't ever seen in the history of the United States.

Secretary SNOW. Congressman, the very able chief economist for the Department of the Treasury, Butch Clarida, the Assistant Secretary for Economic Policy, tells me that I was basically right in saying that the Blue Chip is more favorable than the Treasury's own estimates. And I will share that with you later.

Chairman NUSSLE. Mr. Putnam.

Mr. PUTNAM. Thank you, Mr. Chairman.

Welcome, Mr. Secretary. We are delighted to have you here. In business, you never want to get in a fight with the railroad, but it must be quite a rude awakening on your second day on the job to be in this new position, because it is a little bit different than running a railroad, I am sure.

Two years ago, as a freshman member of the committee, we opened up with the Treasury Secretary and had some really fascinating academic discussions about what to do with the surplus, all kinds of pontification over eliminating entire classes of debt instruments, and how the Government would actually deal with the cash that would be coming in. And certainly things have changed since then.

As Mitch Daniels pointed out yesterday, even if we had never been attacked and incurred no costs of war or recovery from September 11, and no tax relief had become law, we still would be in deficit today as a consequence of the recession and the popped revenue bubble, as he put it.

So I want to talk just a little bit about the dependence of the Federal Government on that revenue pyramid and where that revenue comes from. You have a high percentage of Americans who pay little or nothing in terms of Federal income taxes. For many of them, April 15 is a day when they become eligible to receive money rather than money is due. And for a fairly small percentage of Americans, the Federal Government depends a great deal on the revenues that they contribute to pay the bills.

There are consequences to the structure, to that architecture of revenue. In the President's State of the Union speech, he mentioned that, as an example, that a family of four making $40,000, if his plan were passed, would go from paying somewhere around just under $1,200 a year to $45 a year.

So my first question would be, what is the social consequence of having a large percentage of your population that pays nothing for the national defense, for an interstate highway system, for the level of health care, for the benefits of national parks, what is the social consequence of having a huge percentage of your population believe that those things don't cost anything or that they cost $45 a year?

Secretary SNOW. Again, a good question, probably one that is more philosophical than my practical nature allows me to give a good answer to. But I think there is something inherently troubling about the idea that people aren't connected to the larger purposes of the country through the tax system and don't take an interest, therefore, in a number of the issues that as citizens we would want to encourage people to take an interest in. For instance, the efficiency of their government, the tax policy itself, the fairness of the code.

If you are not in the system, I think you are absolutely right, you take much less interest in the things that the system impacts and affects, and I think that is regrettable. If you asked me to design a code that was perfect, and I could do it and had all of you to vote for it, I would have a code that had fewer deductions, and more people part of it, and lower marginal tax rates.

Now you will tell me how to get there, and I can't tell you that. But in principle, I agree with you 100 percent.

Mr. PUTNAM. Well, the flip side of that, of course, is that a small percentage of Americans are responsible for a high percentage of the revenue that comes into the Government. That is the source of great debate, and rightfully so. It is a fair thing to argue about in this committee and in the Congress at large. The President has taken the position that for tax relief to be meaningful, those who pay taxes ought to receive it. But the larger issue is that a percentage of that volatility in Government revenue is based on the dependence on the revenue generated from a strong stock market which is inherently volatile.

So if you would, please, comment—and I don't have the specific percentage of revenue that comes in as a result of capital gains and the dividends and things like that—but if you could share with us your thoughts on that and a better approach to make the revenue sources less volatile.

Secretary SNOW. You know, I don't have those numbers offhand, but I do remember a discussion with Mitch Daniels, saying that he was absolutely astonished by the importance of that top income tax category to fund the total Federal debt. And I forget the number, but the top 1 percent is something like 27 or 28 percent, and the top 5 percent is something like 47 or 50 percent. I mean, it is a small—a relatively small number of the taxpayers are paying a large portion of the total Federal Government revenue bill. I think everybody who follows the Federal budget was astonished to see those revenues grow as they did with the ebullient stock market we had in 1997 on, and was equally astonished by the collapse in capital gains and high-end options and performance shares and those things that created so much revenue.

Which brings us back to the point we began with, with the chairman, about volatility of the Federal revenue depended on things like the stock market and bonuses.

But in talking about an ideal tax system, I don't think I am going to get a chance to identify or produce an ideal tax system. I think we have got to work with the tax system we have got for now, and make the marginal improvements we can. And the elements that the President has proposed I think are clearly not just minor adjustments, but very fundamental improvements in the code itself.

Mr. PUTNAM. Well, I hope you do have that opportunity. Thank you for being here.

Chairman NUSSLE. Mrs. Capps.

Mrs. CAPPS. Thank you, Mr. Chairman.

And welcome, Mr. Secretary. I want to start with some comments that were made by my colleague, Mr. Baird, yesterday—they were provocative—when he was speaking with Mr. Daniels. He brought to our attention the size of the real budget deficit is actually $480 billion in fiscal year 2004, if we exclude the Social Security surplus from our calculations. And that is the real deficit that we should be talking about. Social Security surplus as we describe it, that so-called lockbox, ought to be off limits. There are claims on that money that we all agree are going to need to be met in the near future.

Second, Mr. Baird noted that we could not eliminate this $480 billion deficit even if we eliminate every nondefense discretionary spending item in the budget. Not cut, but actually eliminate.

Let us set aside that we have been discussing the need for short-term deficits in the current situation which are unavoidable because of the downturns in the revenues to the Government from both the sluggish economy and the President's tax cuts, which I actually voted for, combined with the needs in the war on terrorism both here and abroad. They have put a terrific strain on our budget. And these deficits, which Mr. Daniels has described as nothing to hyperventilate about, are probably that, if we consider just the short term.

But I believe we should all be very worried about running these kinds of deficits year-after-year. And I would like you to address this. But I want you to do so, if you would, keeping in mind that the growth projections from the President already assume that the economy is going to grow 3.4 percent for the next four quarters, and then more than 3 percent annually for the next year. How can we reduce the deficits, already assuming this kind of growth?

Secretary SNOW. Well, let me start by addressing the initial question; and that is, how best to look at the deficit. Is it the unified deficit, or is it the off-balance budget, the debt owed the public budget?

I think it is better in terms of gauging the economic impacts of the economy to look at it on a unified basis, because it is the unified basis that creates the true picture of what is happening in financial markets, how much money needs to be actually borrowed, or how much of a surplus you actually have. So the financial markets will look at it in a unified basis, taking into account the funds from the entitlement programs as well.

But I agree with your basic point. We can't be content to have deficits as far as the eye can see, and particularly deficits that rise in future years. So I always come back to the point that deficits are unwelcome. They are not a happy thing. In this case, they happen to be a necessary thing for some period of time. But there is, I think, OMB Director Daniels probably yesterday emphasized his commitment to keeping us on a course of fiscal responsibility. The President certainly is committed to a course of fiscal responsibility. The deficits are on a unified basis, as I said, and showed in one of those charts we put up, relatively modest in terms of the past experiences and the debt is—this is the deficit itself—relatively modest, relative to, and manageable. When I talk about manageable, I mean in this level.

Mrs. CAPPS. But could I follow up by saying, then, because I want to ask you another topic real briefly—I am assuming then from your answer that unless we include the Social Security Trust Fund and unless we grow the economy by more than 3 percent, that we are not going to be able to do this.

But I actually would like to ask you a question that I asked Mr. Daniels yesterday; because now, as Treasury Secretary, you are also going to be or are a Medicare trustee. And I am concerned about the question that most of our constituents are asking about, which is how to reform Medicare in a way that will allow include coverage for their high-cost medications.

The President's proposal, putting at the core Medicare+Choice or a privatized insurance model, which I haven't seen the insurance companies really jumping up and down about, but would also be paid for with $400 billion over the next 10 years. And I am wondering how you think we can manage doing this since these companies in my rural district have been raising their premiums and lowering their benefits, and then leaving because they have made the case that they can't afford to be there. They are going to be coming to ask us for more money if they are in fact going to be the centerpiece of this Medicare program.

Secretary SNOW. Medicare needs to be reformed.

Mrs. CAPPS. Yes.

Secretary SNOW. But it needs to be reformed with a prescription drug component. And it seems to me every Medicare enrollee should have outpatient prescription drugs. There would probably be broad-based agreement on that. The President's program would use the marketplace, competitive providers under a structured system, so that there would be broad coverage, and avoid this adverse selection sort of set of issues that runs through insurance.

And Tommy Thompson could give you a lot more detail on this, but I understand there is a low-income assistance component to the President's package where they would receive additional assistance to acquire prescription drugs.

But the larger issue, though, is how to make the system more efficient, how to create the right incentives inside the system. My predecessor, Paul O'Neill, spoke eloquently and at length about his efforts in Pittsburgh to go in and apply metrics to health care, to identify—to bring business practices in the Pittsburgh community to the health care providers, and the astonishing reduction in costs in health care delivery systems that came about over the course of a fairly brief period as these management practices, re-engineering metrics, and so on were applied.

I think we can get a much more efficient health care system in America. And, if we don't, we are going to have health care rising from what is it today, 14 percent, in a few years to be 17 percent, and if we don't do it, thereafter 20 percent, an unsustainable growth in this component of the economy.

So I guess I am agreeing with you. This is a subject that needs a lot of work.

Mrs. CAPPS. Thank you.

Chairman NUSSLE. Mr. Wicker.

Mr. WICKER. Thank you, Mr. Chairman.

Mr. Secretary, thank you so much for your testimony today. And I think all members of the committee will agree that the President made the right choice, and we think the Treasury is in good hands. And thank you for the give-and-take that we have had today. Certainly there are differences in philosophy between the two sides of this room. I think it is certainly fair to say we like tax cuts a little more over on this side than maybe my friends on the other side of the aisle. And it is fine for us to have that debate.

I do think it is important, however, for us to make sure that the facts that are stated in this room and on the floor of the House of Representatives are correct, and so I am concerned at some of the disparaging remarks that I hear about the Reagan administration, and also some of the perhaps revisionist history that I hear regarding the early days of President Clinton's administration with regard to budgetary policies and recommendations. And I will agree with my friend from Pennsylvania, Mr. Toomey. I will take 17 years of sustained economic growth any time, the greatest standard of living that any country in the world has ever seen. I applaud the Reagan administration for ushering that in. And I was here as a staff member, Mr. Secretary, when Democrats came across the aisle in a Democrat-controlled House of Representatives and helped Republicans enact those Reagan tax cuts of 1981.

But the thing that concerns me is when I hear that those tax cuts led to record deficits and the run-up in the national debt. So I asked someone to go get me the historical tables, and I had a staff member bring that over for me. And I see on page 29 of the historical tables provided by this committee, that in 1982, revenues increased to the Federal Government. Now, I will tell the truth, they decreased in 1983. But then after that, in spite of these draconian tax cuts, they went up in 1984, in 1985, 1986, 1987, 1988, and 1989 to the point, Mr. Secretary, where revenues to the Federal

Government increased during the Reagan administration by some 60 percent in the face of these tax cuts.

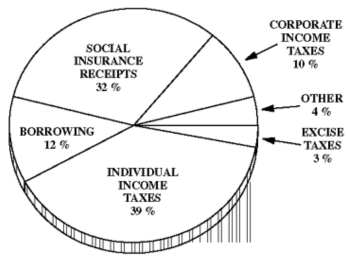
I would suggest to you, and I will ask you to comment in a moment after I make my second point, that maybe there was another reason for the deficits rather than lack of revenue.

And then some of my friends from the other side of the aisle, Mr. Secretary, mentioned the Clinton surpluses. Of course, we on this side of the aisle like to think that the Republican majority that was elected in 1994 had a little something to do with the surpluses, but I think the truth probably is that the economy had a lot more to do with it than anything that we did. But the statement was made that President Clinton in the early 1990s had a plan and a process for getting us to a balanced budget, so I sent out for a copy of President Clinton's February 1995 budget proposal. And I see that during my second month in office here as a member of the new Republican majority, President Clinton came before Congress and proposed annual deficits of $192 billion, $196 billion, $213 billion, $196 billion, $197 billion; and in 2000, $194 billion in deficits were proposed by President Clinton in 1995 before this very committee.

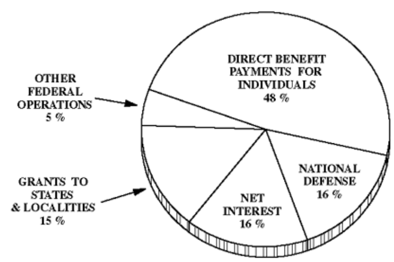
[The information referred to follows:]

THE FEDERAL GOVERNMENT DOLLAR
FISCAL YEAR 1996 ESTIMATES

WHERE IT COMES FROM...




WHERE IT GOES...




**RECEIPTS, OUTLAYS, AND DEFICITS**
(In billions of dollars)

| | 1994 | 1995 | 1996 | 1997 | 1998 | 1999 | 2000 |
|---|---|---|---|---|---|---|---|
| Receipts | 1,257.7 | 1,346.4 | 1,415.5 | 1,471.6 | 1,548.8 | 1,624.7 | 1,710.9 |
| Outlays | 1,460.9 | 1,538.9 | 1,612.1 | 1,684.7 | 1,745.2 | 1,822.2 | 1,905.3 |
| Deficit (–) | –203.2 | –192.5 | –196.7 | –213.1 | –196.4 | –197.4 | –194.4 |
| On-budget deficit (–) | (–258.8) | (–251.8) | (–262.0) | (–284.5) | (–274.8) | (–283.3) | (–288.6) |
| Off-budget surplus | (55.7) | (59.3) | (65.3) | (71.4) | (78.4) | (85.9) | (94.2) |

Now, we felt that we could take a different approach and a different process when we brought in the majority, and so we asked for a tax cut. And it took us a couple years to get it, but in 1997, with the help of some Democrats, we enacted a tax cut. And, you know, a couple of years after that we had achieved a balanced budget in spite of the fact that we had let the American people have a little more of their money back in the form of tax reductions.

So I would ask you this two-pronged question, Mr. Secretary: In light of the fact that revenues increased some 60 percent during the Reagan administration and we still ran up this huge debt, don't you think it was possibly excess Government spending and particularly entitlement spending that caused that deficit? And don't you think that perhaps the economic growth caused us to be able to do a little better than President Clinton proposed to this very Congress during the first months of my time here on the Hill?

Secretary SNOW. Congressman, I—what do they say in the courtroom—I associate myself with your comments. I think the obvious answer to your question is that expenditures rose at a rate that exceeded that 60-percent increase in revenues, and that was a mighty large increase in the revenues.

Now, there was a peace dividend that came out of that eventually that affected the budgets of the 1990s in a very important way, and I don't think we should forget that the investment in the defense under President Reagan and Bush produced a much different world and a much better world, and ended the Soviet Union as we knew it and gave us this large peace dividend.

But the numbers are clear on that. If expenditures had been under tighter control, we would have had huge surpluses. And the numbers you cite from the Clinton budgets of the early 1990s was a reason that a number of us got concerned about the need for the balanced budget approach that certainly became very much part of the Contract With America, as I recall.

Mr. WICKER. Well, I know that my time has largely expired, but I would just encourage the Secretary——

Chairman NUSSLE. It has.

Mr. Thompson.

Mr. THOMPSON. Thank you, Mr. Chairman.

Mr. Secretary, thank you very much for being here. Could I get chart No. 14, please? And while that is coming up, I just want to say I was glad to hear you, in your response to Mrs. Capps, say that it was unacceptable to have debts as far as the eye can see. Because when you were making your presentation, you were asked are deficits—is debt understandable, and you said yes. My note was, but is it understandable to run them for as far into the future as these deficits are running? And as a deficit hawk, I believe that is totally unacceptable. So I am glad that you clarified that.

Secretary SNOW. What I really said is that as long as they are a declining share, they don't trouble me. I mean, I hope they recede just as soon as possible, and I share that with you. But, you know, in running, in serving on boards of major companies and so on, debt isn't inherently a bad thing. We take on debt at CSX because we use the debt to then get high returns on investments. So debt isn't inherently bad as long as the debt is used to accomplish something worthwhile.

Mr. THOMPSON. Well, at this point I believe it is really out of control, and we are paying for that and we are going to pay for that into the future years.

On the first page of your statement, you talked about the typical family of four with two wage earners making $39,000 who would enjoy an $1,100 tax break. And on chart No. 14, the debt tax chart, it shows the tax that these average family of four folks are having to pay. Is there any way that we can calculate into that the offset? Because it seems to me if you juxtapose your example with this chart, there is actually more money being paid, at least by some taxpayers, than they are actually getting back. And you can either answer that now or get that information back to me.

Secretary SNOW. I would like to think about that. The notion of a debt tax is one I am still trying to get my mind around.

Mr. THOMPSON. Well, that is what we are paying as a result of the interest we pay on our national debt. I think it is $1 billion a day that our taxpayers are paying that go to this interest.

Secretary SNOW. But fortunately, it is—I think it is only 8 percent now of the total expense to the Government because——

Mr. THOMPSON. What goes down goes up as well.

Secretary SNOW [continuing]. Interest rates are at historic lows.

Mr. THOMPSON. The other issue that I wanted to touch on was the idea of the dividend tax repeal. And you explained I think at length why you thought that was good. But I have to go back to California this weekend, as everyone here has to go back to their home State. And California is going to experience about a $1.5 billion hit if in fact the dividend tax is repealed. If you add to that what the State treasurer predicts the cost to the State will be in regard to multiple bond funding over the next 10 years, it is about $18 billion and change. And this is going to be not only a direct hit to the State of California, but this is going to make it more difficult to fund some of the exact programs that you were talking about that will help bring us out of these bad economical times. It is going to hurt in both State and local government funding, everything from schools to firehouses to low-income housing.

And that is a rough one to square, I don't care which State you come from. But when you come from one as big as California, it is real tough. And when you come from a State that if you look at our GNP, our ranking amongst the industrial States, we are the fifth largest State. So if the United States is going to recover from this economic downturn, California is going to be a big part of that, and this really puts them back.

And the other thing I want to say about dividend tax is, I understand that there is about 36 percent of the seniors that receive income from dividends, 64 percent don't. So it also becomes a hard one to square when you are talking to that 64 percent who don't get a dividend income, and try to explain to them why we should risk their economic security, especially in regard to Social Security and Medicare, to provide a tax cut to those 36 percent that do derive their income that way.

And it just seems to me that we are—and it is usually us on this side of the aisle that we are accused by our friends on the other side of the aisle for setting up these debates regarding class warfare. But I think these are two examples of class warfare, one in regard to the underfunding or the disparity that is going to be created for funding for low-income housing, schools, and things of that nature, and the other in regard to people who derive their money from dividends vis-a-vis those who derive their money from an hourly job or a salaried job.

Secretary SNOW. Let me respond briefly, and then maybe at some point come back and talk to you at some length on this.

Again, Dr. Clarida has done some studies on this question. I don't know that he has done California explicitly, but he may well have, or his people may well have. But the conclusion of the analysis of the net effects of the dividend proposal and the rest of the tax plan on the State budgets was that it had a positive influence on State budgets, not a negative influence. And you ask, well, how can that——

Mr. THOMPSON. Well, if you would, though. You are assuming that the States would pick that up somewhere else, and it becomes an administrative nightmare that is unaffordable if they try and create bureaucracies to track that income.

Secretary SNOW. Well, I am told that there is a relatively simple adjustment that Treasury can do for the States to put that line on the State forms that can be accommodated if the States choose to decouple, I think is the phrase.

But on your question of the municipal bonds and other such instruments that States and municipalities use, I don't think the dividend proposal will have any major detrimental effect, because, as I think about those instruments, they are in different markets. I mean, people go into those municipal bonds because they want tax-free results, because they want stability, they want fixed incomes. There is a profile of the investor in those that is different than the profile of the investor in equities. And think of it this way. If you are looking for a cautious and safe haven, 1 day's loss of market equity values will wipe out all the gains of the dividend exclusions.

So I mean, I hear you, and there is maybe some byplay there, but I don't think it would be dramatic. And then in terms of seniors, I think it is something like half of all the seniors who file tax returns get dividends of some kind. And I think that is an important fact to keep in mind as well.

Mr. THOMPSON. Thank you. And I would like to see your information on the municipal bonds, because it is contrary to every economic analysis that I have had.

Secretary SNOW. I will follow up with you on that.

[The information referred to follows:]

MR. SNOW'S RESPONSE TO MR. THOMPSON'S QUESTION REGARDING MUNICIPAL BONDS

Two concerns have been expressed about the possible effects on the market for tax-exempt bonds of the President's proposal for eliminating the double tax on corporate earnings. Both relate to the demand on the part of investors to hold and acquire those obligations. The first relates to demand on the part of individuals, the second to demand by corporations. The concerns are that reduction in demand will translate into higher interest rates having to be paid by State and local governments.

The Federal Reserve System's Flow-of-Funds data for the end of 2002 show that individuals, either directly or indirectly through mutual funds and bank trust departments, held about 77 percent of the $1.8 trillion of outstanding tax-exempt bonds. Over the last two decades the portion held by individuals has risen while the volume outstanding has increased substantially. Individuals have increased their holdings because yields have been relatively high in comparison to the after-tax yields on taxable Federal and corporate bonds and defaults rare. They have done so even in years when the stock market was booming. Ending the double tax on corporate earnings will make ownership of corporate stock more attractive and corporate issuance of debt less attractive. In response we expect individuals to increase their holdings of equities and reduce their holdings of corporate debt. Because the dividend yield on equities will continue to be well below tax-exempt bond yields we expect individuals to continue to be attracted to the yield and safety provided by holding tax-exempt bonds. Any diminution in individual demand is likely to be so minor that it would be extremely difficult to detect given the normal fluctuation in interest rates generally.

Three types of corporations hold significant amounts of tax-exempt bonds. At the end of 2002, property and casualty companies held about 10 percent of the total, commercial banks held about 7 percent and other corporations about 6 percent. Corporations find investment in tax-exempt bonds attractive in part because the spread between tax-exempt yields and yields on comparable taxable bonds has in recent years been significantly less than the maximum corporate tax rate. Some corporations, such as banks holding qualified small issuer bonds or corporations having less than 2 percent of their assets invested in tax-exempt bonds, additionally benefit from using interest payments associated with carrying tax-exempt bonds to shelter other income from tax. Moreover, banks are attracted to tax-exempt bonds to meet their obligations under the Community Reinvestment Act. Under current law relatively small spreads between taxable and tax-exempt rates and, in applicable cases, the ability to deduct cost-of-carry against other income raises the after-tax capital gains to shareholders from corporate investments in tax-exempt bonds well above returns on comparable taxable investments. Under the President's proposal after-tax gains to shareholders will still be higher for corporate investments in tax-exempts, given reasonable assumptions about the spread between taxable and tax-exempt yields, corporate dividend payout rates and effective capital gains tax rates. As a result, Treasury analysts conclude that no significant reduction in corporate demand for tax-exempt bonds is likely to occur with the enactment of the President's proposal.

[The following was prepared by staff in Treasury's Office of Economic Policy:]

THE BUSH PROPOSAL AND MUNICIPAL BOND YIELDS (JANUARY 27, 2003)

Some analysts suggest the proposal to eliminate the double taxation of corporate profits will increase municipal bond yields as investors shift their portfolios toward dividend-yielding stocks. However, research papers from several financial institutions suggest a number factors will prevent a significant effect on the municipal market.

- Municipal investors have a low risk tolerance and want to preserve capital. According to Lehman Brothers, municipals have had an annual default rate of 0.004 percent and since 1970 there has never been a default on a general obligation water, sewer, or public university bond rated by Moody's. Eliminating the double taxation of corporate profits will not significantly reduce the difference in risk between stocks and municipals.
- The gain in the after-tax dividend yield on stocks due to the Bush proposal could be wiped out in 1 day due to a change in the price of stocks. The standard deviation of monthly returns is 1.1 percent for municipals versus 5.4 percent for equities, according to Lehman Brothers.
- Even if tax free, the dividend yield on most stocks is unimpressive versus long-term municipals. At present, the yield on the S&P 500 is about 1.75 percent versus almost 5 percent on municipals.
- Municipals are already relatively cheap. Long-term municipals are offering yields very close to long-term Treasury bonds. Given the very low default rate on municipals, it is hard to envision municipals yielding more than Treasury bonds, given that the municipal yield is tax free at the Federal level.
- Municipals offer investors a pre-determined dependable schedule of payments and a final maturity date. These cash flows allow investors (such as financial institutions) to match the timing and amount of cash flows on assets with the negative cash flows on liabilities. Stocks offer no guarantees as to dividend payments or the return of principal.
- Investors purchase municipals for diversification purposes.
- Investors are much more likely to shift out of corporate bonds than municipals. Compared to municipals, corporate bonds are much closer substitutes with equities and have similar underlying credit risk. Municipals are about ten times less likely to default than similarly rated corporates, according to UBS Paine Webber.
- If investors want to shift out of municipals preferred securities are a slightly better substitute than common stock. However, according to Merrill Lynch, 72 percent of preferred securities pay interest, not dividends. Another 13 percent of preferred is issued by REITs and foreign issuers. So only 15 percent of preferred securities would get the benefit of the Bush proposal. That 15 percent consists of about $24 billion in shares outstanding versus a $1.8 trillion municipal market.

Chairman NUSSLE. Mr. Bonner.

Mr. BONNER. Mr. Chairman, thank you very much. I am sorry that my colleague from Alexandria, VA left because I would have liked to have said this in his presence. But since he did, I am going to put it on the record regardless.

Yesterday with Mr. Daniels and again today with the Secretary, it is troubling to hear comments made about “your” President. You know, I didn’t vote for President Clinton. My colleague from Illinois served with President Clinton. But he was my President. And President Bush is my President. And I think it is important, we are in this time of war where the war may expand, and in this time of national tragedy following the Columbia tragedy, that this is not “your” President and “your” President’s budget. This is “our” President. And we can have a friendly debate about how the budget progresses, but I personally would like and hope that as future guests come before this committee, that we can refrain from making these characterizations that are derogatory toward the President of the United States.

Mr. SPRATT. Would the gentleman yield so that I can respond?

Mr. BONNER. Yes, sir.

Mr. SPRATT. I think the gentleman makes a point. And I want to say that for a long time we have made it clear that President Bush is our President. And in particular, with respect to the war, we have said if a war comes, then we will be unstinting about the cost of it, because we want to see our forces prevail. I had an oped piece in the Washington Post yesterday which came down on this budget and the President, but it ended in the last paragraph by asking him for a bipartisan summit. And so I think that indicates a real spirit between us and them. He is our President. We want to see him succeed economically, geopolitically, and in every other way.

Mr. BONNER. Mr. Secretary, you have only had a day on the job, and some of us on this end of the table have had about 2½ weeks so we have got a jump start on you.

I would like to make sure that I understand from your perspective—none of us have a crystal ball and none of us can predict with certainty what is going to happen in the outyears—but what would the effect be if we did nothing?

Secretary SNOW. Well, if we did nothing in terms of boosting the economy, I think we would have a much less certain recovery. There is the Iraq war hanging over us, there is the threat of higher oil prices. There is this lack of confidence I think that permeates the world we live in today, and is seen most dramatically in the performance of equity markets and in investment in the industrial sector, which is waiting to see some reason why they should begin investing. For all those reasons, I think to fail to act would be a mistake. And the cost of failing to act is those additional jobs, those 2 million additional jobs that would be created, that percent plus of additional GDP that we would have, the better lives, the better lives that people would have in a more prosperous economy. That is a high price to be paid for not embracing the better economic policies that take us to more prosperous country.

Mr. BONNER. Prior to your coming to this job, you certainly had a distinguished career in the private sector. One of my concerns is if we don’t do something to make permanent the tax cuts of 2001, that we can’t give working families or corporate America any certainty about what the future holds. What would the effect be of doing nothing to make permanent the tax cuts of 2001? Putting yourself back in your former job, how can you plan past 2010 if there are some set provisions on many of these important tax reductions?

Secretary SNOW. Well, one thing it would do would be to be approximately a 50-percent tax increase on the lowest taxpaying Americans. I think that is unacceptable.

Mr. BONNER. Fifty-percent tax increase on the lowest——

Secretary SNOW. Taxpaying Americans.

Mr. BONNER [continuing]. Taxpaying Americans.

Finally, I would like to just associate myself with the point that the gentleman from Mississippi was making. The Wall Street Journal yesterday had an interesting and excellent op-ed piece that I would commend to all of the members of this committee. And if you have not had a chance, Mr. Secretary, to read it, I would suggest that you do as well: Growth in discretionary spending over the last 5 years, 45 percent; in the last year alone, 9 percent. And we can blame tax cuts, we can blame a number of different factors. And I wasn't a Member of Congress during the previous 5 years, but does not that increase shock the conscience?

Secretary SNOW. I saw Mitch Daniels' numbers that I think he maybe displayed here yesterday that lay out that scenario. We have abundantly funded a lot of discretionary programs over the last 5 or 6 years. I think that is absolutely true. And I don't think we can afford to continue to do that.

Mr. BONNER. Finally as I thank you again for coming, let me share with you a number. I spoke to a group of Federal employees on Friday in my district. And of course, they have different interests than some of the interests we might have. But I found it interesting in doing some research, during the first year of our Federal Government, your department, the Department of Treasury, had 39 employees in 1789. I would hope that we could, as we move forward, find ways to move back toward a smaller government that is less obtrusive to the American people. Thank you again for your time.

Secretary SNOW. You are suggesting that Alexander Hamilton had higher productivity than I do.

Mr. EMANUEL. Don't take it personally.

Chairman NUSSLE. Mr. Baird.

Mr. BAIRD. Thank you, Mr. Chairman.

I wonder if I could have minority staff put slide No. 16 up, and the majority staff post the slide reflecting deficits percent of GDP.

Mr. Secretary, in—could you post that slide reflecting deficits and percent of GDP?

Secretary SNOW. Our slide?

Mr. BAIRD. Your poster. You have referred to it throughout the day.

You have made the point repeatedly, Mr. Secretary, that we must consider deficits as a percentage of GDP; yet in 1995, when you were talking about the benefits of a reduction in deficit, at that point the percentage of GDP—or the deficit as a percentage of GDP is approximately where it is now, according to the chart that I have seen.

Now, if in 1995 you projected that a 2-percent—or that a reduction in deficits could lead to as much as a 2-percent—and that is slide No. 16—could lead to as much as a 2-percent reduction in interest rates, if I am a family with a $200,000 home and my interest rates are reduced by 2 percent, I save about $4,000.

You have talked today about the benefits of a $1,000 tax return for a family of four. It seems to me if my interest rates, if I could cut interest rates, I would be better off.

So deficits are real and they do have consequences. And while it may be important to interpret deficits in the light of percent of GDP, your comments in 1995 suggesting deficits needed to be reduced are almost precisely where the deficit was today.

Could you comment on that, please?

Secretary SNOW. Sure, I would be delighted to.

In 1995, the budget of the United States was projected to be in a sizeable deficit in the years going forward. That was the $200 billion-plus projections that were in the budget of the United States.

Mr. BAIRD. Is that not where we are today, sir?

Secretary SNOW. Yes, but with an economy that is 40 percent, 50-percent bigger.

Mr. BAIRD. But the fact that we are talking relative as a percent of GDP standardizes that out, Does it not?

Secretary SNOW. Well, you are looking here at a set of numbers toward the end of the 1990s that reflected the totally unexpected growth of Government revenues from the buoyant stock market. In 1995, when I got as concerned as I did—and it actually preceded that, Congressman. It preceded it in the early 1990s—in the late 1980s, late 1980s, early 1990s. When I got concerned about this, I was looking at projections of the United States Government for annualized deficits that were up in the 4 and 5 percent range, not the 2 percent range. So I was talking about projections that we were all talking about at that time, and that were alarming not just to me but to many on both sides of the aisle.

Mr. BAIRD. So you were referring at the time to projections?

Secretary SNOW. Sure.

Mr. BAIRD. And yet you didn't say that in the comment. I am not trying to hold you. But the fact was, you were saying if we could lower it by 2 percent from where it is now. Your statement in 1995, sir, didn't say if we could lower it from the projected rate; it referred to where we were at in 1995. And I would assert that we are about there now. And so deficits do have a cost.

Let me ask you a second question, if I may. The gentleman here suggested you should lower the size of your agency. I have met with some of your agents recently, and they tell me that your agency is a toothless tiger; that when they go on enforcement efforts, people laugh at them and assert that if you try to make me pay my taxes, I will file complaints against you.

Now, we all respect the fundamental rights of the American people to be treated fairly by the Department of Treasury, the IRS, et cetera. But what do you think we might be able to do in terms of generating additional revenue if those people who are laughing at your inspectors right now had some respect for them and there were some teeth in that?

Secretary SNOW. Well, I think there is a significant augmentation of the Treasury budget to strengthen the enforcement hand of the Treasury. I think it is $100 million, focused on the higher-end income people, and other enforcement augmentations as well.

Mr. BAIRD. I would applaud that. I have some concerns, however, that apparently, at least as I read the budget proposal, part of that will be privatized. And I have some concerns about the American people having what may well be hired guns trying to collect their taxes. I can tell you that in the realm of Medicare fraud enforcement, this has been an unabashed disaster, and you have got hired guns out treating people very shabbily. And we can say all we want, people love to criticize Federal employees, but I have seen no great evidence that a hired gun is going to treat a private citizen with greater respect than a Federal employee who at least is answerable to an elected Representative who they elected. So I just want to voice my concern. Thank you for your comments.

Chairman NUSSLE. Mr. Franks. Mr. Garrett.

Mr. GARRETT. Thank you. And I appreciate your being here with us and suffering through all this endless questioning.

Secretary SNOW. Well, it is a good education for a new Secretary.

Mr. GARRETT. And it is a good education for a new Member as well. And my only regret is I was not here when Mr. Putnam was here 2 years as a freshman, when the debate was how do we pay off some of these instruments.

I am inclined to take the view that you held more back in 1995 than perhaps you hold today as far as the importance of attacking the deficit problem. I agree with my chairman, I guess his rhetorical question that he made at the outset. He said, well, if we do nothing, we know where we are going to need to go; so, should we do nothing?

And the answer, I agree with him is, no, we have to take this action. And I agree with the line of reasoning that you and the President have with regard to the tax cut, and I am completely behind the notion that the way to do this is to grow the economy and to grow revenue, and that will be the long-term solution to the problem.

But getting to the issue of the deficit today, you made the comment that we have to be concerned about deficit spending. But one of the phrases you used was “except when there are critical needs to be addressed,” and I think everyone on both sides of the aisle will agree that we are in a period of time when there are certainly critical needs to be addressed. But as you said that, I was thinking that when is there a time in this Nation when we would not be sitting at these tables and say that there are not critical needs to be addressed? We had 40 years of the cold war, and I am sure the people that testified then would say there was a rationale for deficit spending, and there was a Great Society and there was certainly a need for moving in deficit spending in those times. I would hazard a guess that any one of us could come up with a program and say that this program that we sponsor for our district or the Nation is a critical need, and we could get over that hurdle of saying, well, this is the one that we have to address.

The critical need that we are dealing with right now is the terrorism aspect, and I think our President is right when he came out right after 9/11 and said, this is not something that is going away in a month or 6 months from now; this is a long-term problem.

So how do we—can you just for a moment address that issue of saying when we don’t have that?

Secretary SNOW. What—the juxtaposition of critical needs in my opening comment was homeland security, the war or terrorism, and creating good jobs for Americans who are struggling. Those were the critical needs I referenced.

Mr. GARRETT. And I agree with them. But I just think that going forward we are always going to have those critical needs. And how do we put them aside to say we want to move toward what Mr. Baird and others were saying, and along the line more in keeping with a balanced budget? I think, I hope, in the future that this committee is going to be grappling with the bigger rules that we are going to be discussing, that you were mentioning at the outset with regard to the framework and the rules, that Mr. Spratt and others were talking about as far as the framework that we deal with in budgets in the future. And you have mentioned the PAYGO rule and how that worked.

And I guess my questions go along the line of this. I think I agree with, although I have to think about this a little bit more, your comment with regard to the PAYGO rule not applying to tax cuts. And I think that is right, but I have to give that more consideration. But you also made the comment that it should not apply to mandatory expenditures. And I will let you respond to this. My thought there is that if we are clever enough, any one of our absolutely critical needs we have in our districts, I think we are probably clever enough that if that was the rule that we had to live with, we could try to turn it into a mandatory expenditure so we could get beyond the rule.

And I think your second comment along that line was if there are certain sorts of programs such as the Medicare program—if there are certain sorts of programs such as the Medicare reform, which we all agree on that we can save spending, then perhaps they should be able to get around rules such as that PAYGO rule. I would hazard the guess also that just about any spending initiatives that we have here on either side of the aisle, that we will always say that if we just spend more money on education or transportation or infrastructure, that we will posit the truth that it is going to actually save spending in the long term.

So if we move all those things off the page, what is left even in discretionary spending that is still within the rules?

Secretary SNOW. Well, if you are suggesting that the game can get rigged, in which everything is off the table, I would agree with you. All games can get rigged in ways that are destructive of the fundamental game. But on the larger set of questions you are raising here, how to frame this whole set of issues, I would have to defer I think to Mitch Daniels and people who know a lot more about this subject than I do.

Mr. GARRETT. OK. Thank you very much.

Chairman NUSSLE. Mr. Cooper.

Mr. COOPER. Thank you, Mr. Chairman.

Mr. Secretary, I have two questions, one macro, one micro. You are new on the job; you have to sell a budget that you didn't prepare. But I would urge you to read page 315 or 318 of this very thick book called Analytical Perspectives, because I am deeply worried that you have been saddled with an unconstitutional recommendation. And I know that you took the oath of office seriously to support and defend the Constitution. But when I read the bottom of that page, quote, "Under the President's proposal, if an appropriations bill is not signed by October 1 of the new fiscal year, funding would automatically be provided at the lower of the President's budget or the prior year's level," that could give 40 U.S. Senators the ability to terminate or radically reduce and cripple almost any spending program in the country.

The Constitution gives Congress the power to appropriate the dollars for spending. So I would urge you to look at this proposal very closely, one that you did not formulate. And overall, I would like to urge the American people to get on-line and read some of these documents, because for all of your smooth skill and calm demeanor, there is a lot in here such as this proposal that is indeed radical, perhaps unconstitutional, and perhaps irresponsible. And it is important that all Americans tune in to these important although arcane issues.

So, could I have your pledge to take a serious look at this proposal?

Secretary SNOW. You can. I accept both the compliment and the challenge that you have given me.

Mr. COOPER. Thank you. At the micro level, you have a very able staff. I am not like my colleague from Alabama who wants to deplete your staff. One of your ablest people is Pam Olson. She is now looking at an issue that has to do with municipal power company prepayment for electricity. A bond issue is currently being held up right now because she will allow prepayment for gas but not for electricity. We would like a fuel-neutral policy so that municipal power companies can help their people with electricity and gas, and be able to prepay for both. So I would just like to urge you and her to take a look at that micro issue, because it could help a lot of consumers all over America having a municipal power company. Thank you.

Secretary SNOW. I will agree to do that.

Mr. COOPER. Thank you.

Chairman NUSSLE. Mr. Hensarling.

Mr. HENSARLING. Thank you, Mr. Chairman.

Mr. Secretary, let me echo the sentiments of one of my other colleagues, that it is indeed, as a freshman Congressman, great to meet somebody who has less seniority than me.

This is my second hearing of the Budget Committee and obviously your first, but we have both had the benefit of seeing a dizzying array of charts put on the screen here for us. I would like to know if the assumptions underlying—if you have the same understanding that I do. No. 1, I believe that I am being asked to believe that with some amount of clarity and exactitude, that we can figure out 10 years in the future exactly what the economy is going to be doing. And, at the same time, I believe these charts that have a large amount of red ink on them are based on the so-called static scoring of the President's economic plan, and that I am being asked to believe that changes in tax rates have no impact on job creation or the economy.

You saw the same charts that I did, Mr. Secretary. Is that your understanding as well?

Secretary SNOW. Yes, broadly. I would not put enormous confidence in 10-year estimates of budget numbers. This may be the best that can be done, but I would look at them with a great deal of caution, as you are suggesting.

I do agree with you that I think they do not reflect, and I think Mr. Daniels was clear in saying this, that they do not reflect the full growth component that would be expected from the tax package, but they do reflect the full cost component. So I would certainly agree with all three of your points, actually.

Mr. HENSARLING. Mr. Secretary, even though the budget does not include the dynamic impact of the economic program, obviously you have seen a number of opinions expressed. What do you perceive is the consensus opinion of the economic impact of the President's economic program?

Secretary SNOW. Talking to colleagues in the business community, and the Business Roundtable put out an estimate. I have seen some others. I would say the official numbers of OMB probably are on the low side of the growth that will actually be achieved. And I think that is true of a variety of the private sector estimators.

Mr. HENSARLING. Mr. Secretary, of all the charts that I have seen posted today, I notice that there are two that are fairly noticeable by their absence. Today, I have not seen one chart that plots the growth of Government over the last 10 years or projecting 10 years forward, even though we did hear earlier today that as recently as last year we had a 9-percent increase in discretionary spending.

I am under the impression that over the last 10 years Government spending has grown at approximately 6 percent. Obviously, the economy has not kept pace with that. There has been some criticism from my colleagues on the other side of aisle that your economic projections are too rosy; that 3 percent or 3.3 percent economic growth in the future is too rosy.

So say, for example, hypothetically, if economic growth over the next 10 years was, say, 2½ percent, and say the Government continued to grow at the rate of 6 percent, given that today the tax burden on the average American family is 40 percent—local, State, and Federal taxes—if these trends continue, do you have an opinion of what would happen to the tax burden on the American family?

Secretary SNOW. Well, I can't do all the math in my head, but I think the direction is pretty obvious. It would be a heavier burden. A heavier burden.

Mr. HENSARLING. Thank you.

Chairman NUSSLE. Mr. Emanuel.

Mr. EMANUEL. Thank you, Mr. Chairman.

This is our second hearing for some of our freshmen, and the second time that we have gone through lunch. And I wanted you to know I started this six-two and 250 pounds, and that is all I have got left. And that you kind of look around, and you begin to feel like you are in an Agatha Christy novel: And then there were none.

Thank you very much, Mr. Secretary. Also I would like to repeat and echo my colleague: It is good to find somebody with less seniority than yourself.

You know, I am going to take a faint attempt at bipartisanship and quote Ronald Reagan. “Facts are stubborn things.” The fact is, although a lot of people want to review the 1980s versus the 1990s and what led to economic growth, the fact is that in the 1990s we had a record period of job growth. Fact: We had a record reduction in the welfare roles.

Fact is that we have also in the 1990s extended the trust fund for Medicare by 20 years. Fact, we had a drop in those who worked full-time and didn’t have health insurance, down to 38 million. And fact is we also had a drop in violent crime in this country and we did all that without tripling the Nation’s debt. So although people can take rightful pride comparing the 1980s and the 1990s as a period of economic growth and what happened, just a simple fact, and I would like to quote Ronald Reagan on that, “facts are stubborn things and those are just facts.” And that may be hard for some people to swallow, and I appreciate that, but that is what happened.

And with that, I think it is worth noting since some people like to compare 17 years of Ronald Reagan’s economic growth, we do think something happened in the 1990s that was certainly magical. There is no doubt that it started with the entrepreneurs and the middle class families around the country, and also with the decisions, whether people like it or not, because I don’t want to just do nothing about welfare reform. We did something about welfare reform. And doing something in Washington does have an impact.

The arguments to the 2001 tax bill was that the President inherited the recession and he needed a $1.3 trillion tax cut to get the economy moving. Since that time the economy has lost 2½ million jobs. Four more million Americans are without health insurance that had health insurance before. And I think you will appreciate this, is that also nearly $1 trillion of corporate assets have been foreclosed on in chapter 11. And one of the facts I am most impressed with between the 1990s was the fact that we decreased the amount of people living in poverty but in fact in the last 2 years two more million people have been added to the poverty rolls in this country, just facts.

And I do think the decisions we make here rather than just static and not doing anything have an impact on the economy and on what happens, and I do agree that we all want to see job growth and economic growth. We want to see deficits lower. But one of the things we want to see is every American participate in that and that hasn’t happened to date. The unemployment, the uninsured are not equally shared across every income group. And I agree with what you said, deficits can be manageable if they are seen as cyclical. But once the markets sees the perception go from cyclical to permanent, interest rates rise and that has an effect on mortgages, college loans, paying for health care bills and it becomes a tax on the families. And we are very close—and you may be right and I think you are right, right now they are seeing them cyclical. But that moment that perception changes in the market that they are permanent and fixed and structured, nothing we are talking about the tax cuts here will pale in comparison to the rising costs of managing to pay for a home, paying for college or paying for health care.

With that, I do want to talk a second about savings. Fewer than 5 percent of the American people participate in the IRAs as they exist, the Roth IRAs. And why do you think that increasing that limit is going to increase the participation that only 5 percent of the top bracket participate today? To my view since $3,000 a year is out of reach for a lot of Americans to put away, making it $7,000 is only going to be putting more money away for those who want to participate and try to save. You are just going to go to the same people who today participate in the IRA and we are not going to extend it.

Now I think if you look at all that money that is going to go toward that savings, some people see critical investments in agriculture. Folks like me see critical investments in education. Right now we can't even pay for the President's initiative of Leave No Child Behind. This budget, the amount of deficits we leave, the amount of debt we add and the ability not to invest it, Pell Grants or in education, do have consequences because American lives aren't static. Washington may want to be static, but their lives are not.

Secretary SNOW. I agree with much of what you had to say.

Mr. EMANUEL. There is an act of bipartisanship right there.

Secretary SNOW. One of the important proposals coming out of the Treasury deals with the issue you are raising, the low savings rates among the lower income, below the median people. The failure to use the IRAs and the Roths and 401s and so on—and I would urge you to take a look at this proposal. Pam Olson was mentioned earlier as somebody that the committee works with closely, which really she is the rowing oar on these LSAs and RSAs which would create a new savings vehicle. The current tax favored vehicles are just too complex on the one hand and too restrictive on the other. They limit the purpose so that that mother who wants to educate her child, she puts her money into the fund and the child gets sick, she can't use it to help deal with the medical problems of that child, so they don't use it. And I commend Pam and the Treasury Department for coming up with these proposals to make—create new savings vehicles to encourage more savings among middle income and lower income people. Wealthy people have lots of ways to save. It is the lower income people that need to have savings facilitated. So I urge you to take a look at these proposals.

Chairman NUSSLE. Mr. McCotter.

Mr. MCCOTTER. Thank you, Mr. Chairman, and I would like to thank the good member from Illinois for his bipartisan praise of the 1990s-led GOP House of Representatives. You mentioned something about the debt tax and that is something I heard a lot about. It is a new term, although I am fully expectant that I will be hearing that term over and over again at least for the next year and 11 months. I think I might have an idea of what it is and I just want to see if I can be correct, and then I have a quick question. It seems to me that the debt tax is caused by politicians' need to immediately spend money in the hopes that it will lead to long-term structural improvements in the economy when in the end it is basically a mortgage and a hope that Government spending will help improve the economy and the quality of peoples' lives. This naturally will limit the amount of discretionary spending that will be available later. So in my mind it becomes basically a debt penalty.

It gets confusing because we heard the overall accumulation of Government debt in relation to individual budgets, and there was never a proration for how the immediate spending influenced those future budgets. And I think that that was kind of apples to orangutans or something. I think under that kind of logic there are really five things that can be done. You can individually—you can raise taxes. You can individually cut prorated reductions in the programs that were benefited by the immediate spending at the expense of future spending. You can have larger cuts in all other programs whether affected or not. You can obviously go across the board spending freeze because we heard that will lead to a balanced budget or you can hope through some type of budgetary policies you can grow the economy and restrain spending and arrive back into a surplus situation.

I didn't study economics. I was a liberal arts guy so I may be wrong about some of that. But my question is in investing the 1990s—I was a state legislator. I was a county commissioner prior to that—at the end of the 1990s, we saw, I think it was historically the largest increase in Government revenues and we also saw one of the largest increases in Government spending and that was followed by a recession. We have heard a lot about deficits having consequences on markets, a debt—the cost of having a debt at the national level. I was wondering if anyone had looked into the prospect of a national surplus also constituting negative consequences to our economy when the Government takes too much from entrepreneurs and the people who make this country great, the working men and women and then spends it inefficiently.

Secretary SNOW. Congressman, you may not have studied economics formally but you have obviously learned it some other way, because you are framing the issues the way the economist would frame them. I saw a speech that Larry Summers gave recently in which he said no one can be well educated today if they don't have a fundamental understanding of economics. And economics is basically the study of trade-offs and choices and the costs of alternative choices and framing the choices intelligently. You just did, and I agree with the way you framed them. It is important to always ask what is the cost of not doing what we are proposing as well as what is the cost of doing it. And where the cost of not doing, what you give up is greater than the cost of doing it, you should give it up.

So I think the President's program is the course that takes us and puts us on the best course in terms of those trade-offs that you have enumerated.

Mr. MCCOTTER. I just want to thank you very much. In the final analysis, though, I do believe a historical precedent is important, and I do believe that had we perhaps at the State and local level, because I can't address the national level, saved some of the money that the taxpayers put here into reserve accounts, into rainy day funds, perhaps we might not have offset the entire cost of this proposed budget but would have laid a foundation for a rainy day fund much like families have to do. And my concern is that we do not attempt to bolt the Federal budget on the backs of family budgets no matter what direction we take.

Secretary SNOW. I agree with your large point there.

Chairman NUSSLE. Ms. Majette.

Ms. MAJETTE. Thank you, Mr. Chairman, and I would like to have displayed slide No. 3. Can you display slide No. 3? And good afternoon, Mr. Secretary. I appreciate your patience and your fortitude. In my previous life I was a trial court judge and I certainly wouldn't have had a witness on the witness stand as long as you have been without a break.

Secretary SNOW. Cruel and unusual.

Ms. MAJETTE. But I certainly appreciate your being here this morning and this afternoon, and we have talked a lot about the cost of doing or not doing things and trade-offs. And before I ask my question I would just like to preface it with some reading that I did this morning, and this is from a book written by Richard Kriegbaum on leadership and particularly on the aspect of creating a budget. And he says that, "The core values of an organization are the promises its members make to each other. The budget is the most comprehensive and detailed description of what the organization has promised to do in expressing those values. What makes budgeting so difficult for a future oriented leader is that the budget is mostly about history, about keeping promises that have already been made. If the promises were made wisely, they will have created a good set of present opportunities, attract great people, secured a strong position in the market with a positive image and allowed for increasing net revenues. The need for growth is a product of the fundamental paradox in each budget. Driven mostly by the promises of history, the budget must also make promises to secure a future. The budget, mundane and arcane, is the ultimate leadership forum."

Now my question is given the fact that we have the baby boomers, the baby boom generation will begin to collect Social Security benefits starting in 2008 and also having the Medicare coverage and that those are promises that we have made, made by past and current Presidents and by past and current Congresses, how are we going to be able to honor those past and current promises in light of the deficit we already have and the proposed budget that will increase those deficits as we move forward to 2008?

Secretary SNOW. I begin by saying that our commitments to Social Security and Medicare are sacrosanct. It is unthinkable that those commitments won't be made. At the same time, it is important to recognize that, as you are suggesting, that the demographics of the country are putting us on an unsustainable basis in terms of the current course. So some fundamental reforms need to be thought about in both areas.

The President has made clear his commitment to Social Security, but also is engendering a national dialogue on how to put it on a sustainable basis. The commission he appointed came up with three options. All included investment retirement accounts—I guess two of the three—all three had investment retirement accounts as part of the approach. The Social Security system needs savings. It needs an infusion of real savings. And we need to find a way to make that happen. It can only happen, though, I think, and we can only put Social Security on a sustainable basis if, one, we grow the economy, because that gives us the wherewithal to deal with the problems, and, secondly, if there is a bipartisan consensus to move forward on that issue.

On Medicare, health care, the commitment is the same. The problem is a little different. It is driven by demographics, but also by this extraordinary increase in health care costs, which we have to rein in. We have to bring greater discipline and efficiency to the health care delivery system. We talk about that a lot. We talk about that a lot. But it is an issue that has to get joined.

So I applaud you very deeply for putting that issue before the committee and before the Congress because it is one that we simply have to address.

Ms. MAJETTE. Thank you.

Chairman NUSSLE. Mr. Ford.

Mr. FORD. Thank you. We are here, as you know, Mr. Secretary, talking about this budget stuff after or during the time in which Secretary Powell has made quite a compelling statement about the world taking steps against Iraq and even an invasion of Iraq. I know that you have a tough gig, made tougher by the fact that you didn't really have a job in writing this budget, but you have to defend it and perhaps you do fully agree with it. But some of the things you said in the past which I think we tried to point out here are in conflict with the direction that this budget will take us. I want to ask specifically just a couple of questions.

I am reading this morning in the CQR, one of the local newspapers here on the Hill, where your friend and colleague Glenn Hubbard makes the point that because of dynamic scoring that the costs of this tax cut, the $695 billion tax cut, would actually be less some $280-billion less, $278 billion to be exact, and that it would actually cost only $417 billion over 11 years. I was curious, one, if you are familiar with his talking about this and, two, if you agree with this dynamic scoring.

Sounds a little like fuzzy math to me. I know a lot of people here have talked about what counties have to do and what families have to do. I would love to be able to go into a grocery store and fill up my grocery cart and say it looks like it is 250 but by the time I get to the counter maybe it will only be 185. I am curious to know if you agree with Glenn Hubbard's estimation about this.

Secretary SNOW. Actually I have not discussed that with the CEA chairman.

Mr. FORD. If you could get back to me on that and maybe the chairman. I know he is a fan of dynamic scoring as well. Perhaps he can get back to those of us on the committee if he too agrees with Glenn Hubbard's estimations here.

Chairman NUSSLE. Will the gentleman yield?

Mr. FORD. As long as you don't take my time.

Chairman NUSSLE. I will be glad to not take it from your time. I am just curious. So your point is that you see absolutely no impact at all from our fiscal policies on the overall economy and that it should not be taken into consideration?

Mr. FORD. No, sir. I am just asking the question. Evidently you are giving me a partial yes. I would love——

Chairman NUSSLE. It is not a partial guess or a yes. I just wondered if you saw no impact at all from fiscal policy on the economy.

Mr. FORD. Mr. Snow has run a railroad that runs through my city of Memphis, and has done very well in business. You, Mr. Nussle, have been head of the committee. I am just curious. I asked the question for this reason. I was not on the committee 2 years ago, but I understand having voted against the budget that came out of this committee, there were a lot of estimates about how well the economy would perform after the tax cuts that Congress passed 2 years ago. Well, in fact, that has not happened. We heard a variety of reasons why. It is ridiculous some of the things that everybody said, particularly—I have a lot of friends on that side of aisle. But to suggest that Clinton had something to do with this or that Reagan had something to do with this or that one person deserves more credit than the other is ridiculous. Let us face the facts we face right now. If that is the case and if it does not happen, what is our fallback here, because we estimated over the next 2 years all these things would happen with this tax cut and it is not happening.

And I will be happy to yield to the chairman if he wants. The second question I would have for Mr. Snow with regard to the stimulus package, and I would love to get a copy of your memo you sent to Mr. Thompson on municipal bonds and other tax free instruments, including the low income housing tax credit that Ms. Johnson raised yesterday, I think, before the Ways and Means Committee. But I am curious about States. My State, like many others, is faced with these crushing burdens. Is there not an argument—and I am not an economist. I went to a school where they teach it up at Penn and Wharton, but I didn't take any of those classes. I was a liberal arts major like the former commissioner and State representative over there was. I am curious—it would seem to me though, what little I know, that the best thing we probably could do would be to help Governors avoid either raising taxes or cutting vital services. And if we don't provide some direct aid to the States, is it your belief that that may offset what we may do here at the Federal level whether it is dividend taxes or payroll tax rebates or whatever we eventually settle on?

Secretary SNOW. The best thing we can do for the States is to create a strong national economy that grows and as that strong national economy grows and the States have more jobs, more revenues will flow to the States. And the analysis I have done—I introduced Dr. Clarida earlier who has done these analyses. The States actually pick up in the aggregate more revenues as a consequence of this growth package than they would have otherwise.

Mr. FORD. So it is your belief that providing direct aid to the States for health and education and other needs, and this is not to suggest that we don't have other priorities but I am just curious, modifying the Medicaid formula so that my State—and Tennessee is faced with a $400 million shortfall this year and an expected larger one next year. That is small compared to some of the other States represented here. But you don't believe that providing some direct aid in addition to the stimulus jobs and growth package that the President talked before Congress a week or two ago, you don't believe direct aid could also help alleviate some of this burden and actually help create jobs and grow their economies at the State level as well?

Secretary SNOW. I forget the numbers. You would know them because you were here yesterday when Mitch Daniels testified, but as I recall there was a—here is the chart—these are OMB numbers. You can see there has been a fairly sizeable increase in grants, Federal grants to State and local governments, and that is continuing in this budget.

Mr. FORD. How much of that is Medicaid? I must have missed that part of Mr. Daniels' testimony. It is my understanding a little over three-quarters of that was Medicaid funding if I am not mistaken.

Secretary SNOW. The numbers escape me right now, but I will get back to you on that for sure. I know Medicaid is now, I think, the largest source of the grants to the States and I think the second largest item in most State budgets.

[The information referred to follows:]

MR. SNOW'S RESPONSE TO MR. FORD'S QUESTION REGARDING MEDICAID FUNDING

Total Federal grant-in-aid money to state and local governments was $351.6 billion in fiscal year 2002. It will rise 9 percent to an estimated $384.2 billion in 2003 and an additional 4 percent to $398.8 billion in 2004 under our budget proposal.

A huge 20 percent rise in Medicaid grants is slated for this year, boosting them from $147.6 billion in fiscal year 2002 to $176.8-billion under current law for fiscal year 2003. These grants are expected to rise 3 percent further to $182.5 billion in 2004 (amount takes account of proposed legislation).

The rise in Medicaid costs in fiscal year 2003 is expected to account for 89.6 percent of the increase in total grant-in-aid in that year, but the rise in fiscal year 2004 would make up only about 39 percent of the increase in grant monies.

Medicaid expenditures accounted for 42.0 percent of total Federal grant-in-aid to states in fiscal year 2002; the share is expected to rise to 46.0 percent in fiscal year 2003 and account for 45.8 percent of grants in fiscal year 2004.

Mr. FORD. If you could have drafted this budget, Mr. Secretary, and you were trying to craft a stimulus package in light of the challenges we face and with the vast experience you have had in the private sector, public sector, is this the budget you would have drafted and presented to this Congress and suggested to this Nation to help create a rebound and a growth period, including job creation?

I know I am going over my time. I think I know what you may say, but I am just curious if this is the budget you would have presented to this Congress had you been on from the very beginning with this administration.

Secretary SNOW. I am very pleased to be in a position to advocate the policies reflected in this budget. I shy away from using the term "stimulus" because I think it mischaracterizes what this package is all about.

Mr. FORD. I would agree.

Secretary SNOW. It really is a growth package.

Chairman NUSSLE. Mr. Secretary, let me just—excuse me—let me yield to Mr. Davis and then I will take some time at the end. Mr. Davis.

Mr. DAVIS. Thank you, Mr. Chairman. Mr. Snow, I apologize to you that I missed a lot of your testimony. I have some pressing constituency issues in my office, but I did see a lot of you on television this morning. Let me ask a question that is totally different from what you have been asked about during most of the day. I want to go to the larger point of incentives that this budget creates and I want to talk about incentives in one particular area. I want to preface that by saying that two things are apparent to me as I look at the political context around this budget.

First of all, it is evident that whether we agree or disagree with the whole range of cutbacks that are made in this budget that there are a range of objective cuts or reductions in the rate of growth for a number of social programs that I consider important, from education, health care, Head Start, you name it. Because of that, it strikes me that there is going to be a much greater reliance on the private sector, a much greater reliance on the private sector to step up to the plate when it comes to charitable giving. The President has spoken very eloquently of compassionate conservatism. He has spoken very eloquently of the private sector and the private community in this country assuming some of the burden that the Government may be advocating.

Given that set of premises, I want to ask you about this budget's failure to provide more incentives for charitable giving. Pull out just a few facts that I have seen in the budget. The President is proposing a $500 charitable deduction for nonitemizers. Now based on numbers that I have seen, the average charitable gift for most taxpayers is $348. The range between $348 and $500 is significant at that level, so as a practical matter most people who were giving charitably will not receive a tax incentive.

Give you some more numbers. Two years ago when the President sent his first tax cut plan up to Congress, he proposed a $90 billion—what would have amounted to a $90 billion charitable tax break over a 10-year period, about $9 billion a year. That plan was not successful. In this go-around, the President comes back with a $20 billion plan for reductions in charitable giving over 10 years. That seems to be a significant retreat on the part of the President.

Two other aspects I will point out to you. A lot of charitable foundations—in fact, my understanding is that all private charitable foundations, while they are not taxed in the normal fashion, pay an excise tax that totals up to $1.4 billion a year. This budget provides no relief from that excise tax.

Finally, as I understand it right now, if people withdraw money from an IRA and attempt to give it to charities, that is still taxed. Now that is a classic case of double taxation. The budget the President proposes does nothing about that.

So my question to you is this: Given the extraordinary shift from public sector to private sector the President seems to contemplate, how can you justify to us and, more importantly, to our constituents why the President doesn't do more in this budget to encourage charitable giving?

Secretary SNOW. I am not as conversant with this subject as you obviously are, but I will give you two broad answers. One, the best way to stimulate charitable giving is to have a stronger economy so people have more money in their pockets, more disposable income. This proposal does that. I am confident of that. The IRA proposal that we talked about earlier, Congressman, when you weren't here, the Treasury proposals there, does permit transfers to charities. It creates a more flexible use of these savings accounts and

I think will encourage savings generally and, by creating more flexible uses, will be helpful to charity generally. And I understand that in the budget there is some several $100 million in effect directed to charitable causes.

Mr. DAVIS. Let me ask two follow-up questions, Mr. Secretary. Would you support the legislation that has been introduced in the Senate, as I understand it and that some of us will cosponsor in the House, that would lift the excise tax on the charitable foundations?

Secretary SNOW. I have to study that. I am not up enough—I wouldn't want to give an off the top of my head answer.

[The information referred to follows:]

MR. SNOW'S RESPONSE TO MR. DAVIS' QUESTION REGARDING EXCISE TAXES ON CHARITABLE FOUNDATIONS

The administration's fiscal year 2003 and fiscal year 2004 budgets include a proposal to simplify the excise tax on private foundation investment income. The administration has not proposed repeal of the excise tax. Under current law, the excise tax rate is 2 percent, but the tax rate may be reduced to 1 percent if the foundation's charitable distributions exceed its average level of charitable distributions over the five preceding years. The administration proposal is intended to provide simplification and some amount of tax relief for foundations by replacing the current two-tier rate structure with a single 1-percent tax rate. The current formula, in addition to imposing recordkeeping burdens, can discourage foundations from increasing charitable distributions in a particular year, because it would be more difficult for the foundation to qualify for the reduced rate in subsequent years.

Mr. DAVIS. One more question. Can you give me some explanation of why the President has by his own terms retreated from his $90 billion goal of 2 years ago as far as charitable tax breaks to a considerably less ambitious goal of $20 million?

Secretary SNOW. This is an area that I am beyond my ken. I wasn't here when the President made whatever the original proposals are and I am not really familiar with what the proposals are in this budget, but I will be happy to look into that.

[The information referred to follows:]

MR. SNOW'S RESPONSE TO MR. DAVIS' QUESTION REGARDING THE PRESIDENT'S GOAL ON CHARITABLE TAX BREAKS

The administration's fiscal year 2004 budget proposals reflect legislative developments. The charity bills considered in the House and the Senate in the 107th Congress were both much more modest bills than earlier proposals. In addition, there were bi-partisan meetings between Congressional leaders and the White House last year that produced a consensus package. The current budget proposals reflect those considerations and would provide significant new support and incentive for taxpayers to increase their charitable contributions.

Mr. DAVIS. Thank you, Mr. Secretary. Thank you, Mr. Chairman.

Chairman NUSSLE. Let me just take a little bit of time here because Mr. Ford brought this up and I have enormous respect for my good friend from Tennessee. Just to make it clear, I am not a fan of either static nor dynamic scoring. I am a big fan, though, of accurate scoring, and we haven't had that under any model that I have seen as of now and that frustrates me and I know it frustrates the gentleman from Tennessee. So just to correct the record.

Mr. FORD. I didn't mean to cast any aspersions. I know I heard a lot of people talking about dynamic this and dynamic that yesterday and I thought I heard you saying you support dynamic scoring.

Chairman NUSSLE. And that gets me to the second part. I am not sure what to call it, but—well, let me just ask the Secretary. Does the President in the budget that has been presented before Congress score his growth package in a dynamic scoring model or methodology?

Secretary SNOW. The budget builds in some of the growth that would come as a result of the tax incentives in the plan, but it is not fully built in; that is, it doesn't play through all the consequences of enhanced incentives for savings, investment and consumption, nor does it, to my knowledge, fully take into account the removal of the inefficiencies that are associated with the current Tax Code, in the area, for instance, of the dividends. So the way I look at it, it certainly scores all the costs of it, but probably doesn't reflect all the benefits.

Chairman NUSSLE. And I guess it is puzzling because I asked the same question of Mr. Daniels yesterday and he said no, it is not dynamically scored. In fact, the way I understood it was that if, in fact, OMB's growth figures are less than CBO's and Blue Chip and both Blue Chip and CBO assume nothing basically is changing, I don't know how anyone could assume that that scores dynamically, or assumes any growth or assistance from the growth package that the President has put forward. And I guess that is what I am getting at. I am wondering why you don't in the budget assume growth larger than status quo from this growth package.

Secretary SNOW. I think it is—the decision to err on the side of conservatism basically lies at the base of that decision and build in conservative numbers rather than otherwise. That is the only explanation that I can see for it.

Chairman NUSSLE. Let me ask you one other thing because the gentleman from Tennessee said this. He said obviously there was no changes or there was no growth, there was no economic benefit from the package—the growth package from 2001, the tax cuts from 2001. And unless I am missing something, that not only was not your testimony but I am not aware of any economist that suggests that this was a recession that is typical based on the dynamics that were out there at the time, that there is nobody with any kind of economic credentials that is suggesting that there was no impact in a positive way from the 2001 tax cuts that were passed. Now somebody may think it didn't go far enough or it could have had more economic impact, but to suggest that there was no dynamic impact, just, I am surprised at because I am not familiar with any school of thought that suggests that there was absolutely no impact from the 2001 tax cuts. What is your belief on that?

Secretary SNOW. Well, my belief is that the 2001 package was essential to avoid a deep recession and was the right medicine at the right time. And if it hadn't been done, if Congress hadn't stepped up to the plate with the 2001 tax package where I was sitting in the private sector, I was looking at the prospect of a very deep and serious recession. We ended up with—I think it is the shallowest and shortest recession since the Second World War. So I think it was the right medicine at the right time and the consequences were obvious. The Congress, by taking the steps you did, put us on a much faster recovery than would have been the case otherwise.

That means lots of additional jobs and lots less misery for a lot of people.

Mr. FORD. Mr. Chairman, I didn't actually suggest that there has been no impact, if I can indulge for one moment. I was only making the point—two points. One, there is an estimated $278-billion less that—$278-billion less of an impact on the bottom line, and there was a lot of impact on what the package that was passed in 2001 would accomplish. Now if I am hearing correctly, instead of losing by five touchdowns, we lost by three. Might have covered the spread, but we still lost. And the only point I was trying to make, I still want an answer from you, Mr. Chairman, and maybe you have answered it already, but from the Secretary, is there a belief in the White House about what Mr. Hubbard said, that the cost of this tax cut, that the economic surge could offset 40 percent of the plan's cost? I think that is a pretty significant offset.

Chairman NUSSLE. Did he say "could"? What is the quote?

Mr. FORD. "White House official says economic surge could offset——"

Chairman NUSSLE. Could?

Mr. FORD. Clearly——

Chairman NUSSLE. Not definite, not "I am betting my house on it," but "could?" Why isn't that fair to say that could be the case? Using your analogy, using the analogy of the gentleman walking through the grocery store buying food and that it has no impact at the end of the counter, doesn't recognize, but it does have an impact because at the end of the day hopefully he has had dinner and hopefully his stomach is full. So there was an impact.

Mr. FORD. Walking through the grocery store and hoping that things go on sale before you arrive at the counter is my point. I am only telling you what the man said. Now if you agree—I am asking the Secretary. If you agree with Mr. Hubbard in his characterization that it could be offset by 40 percent, there is no need to be defensive with me. You and I represent people we have to go home and explain this to.

Chairman NUSSLE. Let me reclaim my time and answer your question. Yes, it could.

Mr. FORD. Fair enough.

Chairman NUSSLE. And let me continue to reclaim my time and suggest to you that I don't believe that dynamic scoring which, A, nobody can yet define and, B, there aren't any models that anyone that I am aware of is yet ready to roll out and suggest this is the be all and end all economic model. But to suggest what we currently suggest, that fiscal Government policy has no impact—no impact on today, tomorrow, the next year, 10 years from now—is living in an unbelievable vacuum that I don't think is realistic either. But to be able to predict it, no, I think you are correct and that is why we share, whether it is bipartisan or whatever, is that we need better, more accurate scorekeeping and more accurate estimates as we look at today, tomorrow and the future.

Mr. FORD. Do you think Mr. Hubbard, who holds a fairly significant position at the White House, him making this comment that it could cost $278-billion less, but could that influence some of you and our colleagues here in the Congress? Could it have us believe that this thing won't cost as much and somehow or another——

Chairman NUSSLE. Why is it unfair for us to consider—let me just ask it back. Why is it unfair for us to consider whether this could affect us in a positive way when I have been hearing all day for the last 2 days how it could not from your side; that it may not; that it may be the worst medicine? If you could look at the positive, you can look at it from the negative.

Mr. FORD. I am holding fast to the notion that could not. But I wanted to get Secretary Snow on record as saying that he believed that he could.

Chairman NUSSLE. Reclaiming my time, that is why we have budgets. That is why we have plans. That is why we have parties. That is why we have votes. And that is why we need to have this discussion and we need to put our plans on the table. We hope to see a plan from your side. We have seen the plan from the President. We hope to see a plan from your side and then we will be able to make a decision.

Mr. Spratt.

Mr. SPRATT. Three quick points. If I could, Mr. Secretary, give you a handwritten request for some additional information. I just had no other method other than to hand write it out. We would like some backup data about the assumptions about the revenues that will be gained or realized from your new savings proposals and then the revenue losses that will ensue as these tax shelters build up and accumulate. I think your 5-year summary is that it will generate $14 billion in revenues over 10 years. We would like the assumptions you are making about who will transfer out of traditional vehicles into new vehicles.

Second point, I could offer as a witness, but ask the former chief economist of OMB who is sitting right behind me, Joe Minarik, who has been in this budget process for 20-odd years, and he will tell you that OMB does consider the behavioral effects of various economic policies in putting their documents together. They don't get into alchemy. They don't get into magic elixirs and things like that. They take very basic views, which is what we want them to do. There is a passage from David Stockman about how the first cut on the 1981 tax cuts was treated, where the bottom line came out and he gave it to Mary Wheatenbaum and said what can we do about this, we can never sell that, and Mary Wheatenbaum says I can take care of it right here. That is where the assumptions will come from. Very gut judgments. We don't want that, OMB, Treasury or CBO or anywhere else. We want very, very basic assumptions that have been demonstrable in the past from other fiscal policies.

And finally, Mr. Chairman, as we spoke, the Treasury issued a bulletin indicating that the Government is about to run out of borrowing authority by February 20, according to the Treasury's forecast. They will hit the ceiling and will have to engage in some stopgap practices in order to keep going. I doubt that we will get anything about that around here by February 20, but I am concerned that this is a sign of things to come. It may not be the last time we will have to raise the debt ceiling.

Mr. FORD. I would still be curious. I know Mr. Nussle has answered, but I would be curious to know at some point after you have had an opportunity to review Mr. Hubbard's estimation about what could happen, I would be curious to know your thoughts, if you share his belief that an economic surge could offset 40 percent of the $695 billion tax cut proposals. I know you said you hadn't had a chance to look at it. I would appreciate if you would be able to respond to that.

[The information referred to follows:]

MR. SNOW'S RESPONSE TO MR. FORD'S QUESTION REGARDING THE TAX CUT PROPOSAL

I believe the extra economic growth produced by the administration's Economic Growth Package will offset a significant portion of the official budget estimate of its cost. A study released by the Business Roundtable shows the tax cut will offset one-third of the official cost estimate, with most of the offset generated by the dividend proposal. A simulation run by the Council of Economic Advisers suggests revenue from extra economic growth could offset about half of the official cost of the proposal during the 2003–07 period.

The tax cut will reduce the cost of capital for corporate equity investments, leading to an increase in the stock of corporate capital. By reducing tax distortions, it will also enhance the efficiency with which capital is allocated. Other potential gains from the tax cut include those from lower debt ratios, more appropriate corporate payout ratios, higher labor supply, and greater investment by small businesses.

COMPARISON OF ECONOMIC ASSUMPTIONS

[Calendar years]

| | Projections | | | | | | Average |
|---|---|---|---|---|---|---|---|
| | 2003 | 2004 | 2005 | 2006 | 2007 | 2008 | 2003–08 |
| Real GDP (billions of 1996 dollars): | | | | | | | |
| CBO January | 9,673 | 10,018 | 10,358 | 10,697 | 11,037 | 11,380 | .............. |
| Blue Chip Consensus January [2] | 9,704 | 10,050 | 10,383 | 10,709 | 11,041 | 11,384 | .............. |
| 2004 Budget | 9,710 | 10,061 | 10,414 | 10,760 | 11,102 | 11,446 | .............. |
| Real GDP (chain-weighted):[1] | | | | | | | |
| CBO January | 2.5 | 3.6 | 3.4 | 3.3 | 3.2 | 3.1 | 3.2 |
| Blue Chip Consensus January [2] | 2.8 | 3.6 | 3.3 | 3.1 | 3.1 | 3.1 | 3.2 |
| 2004 Budget | 2.9 | 3.6 | 3.5 | 3.3 | 3.2 | 3.1 | 3.3 |
| Chain-weighted GDP Price Index:[1] | | | | | | | |
| CBO January | 1.6 | 1.7 | 2.0 | 2.1 | 2.1 | 2.2 | 2.0 |
| Blue Chip Consensus January [2] | 1.6 | 1.9 | 2.1 | 2.1 | 2.1 | 2.1 | 2.0 |
| 2004 Budget | 1.3 | 1.5 | 1.5 | 1.7 | 1.7 | 1.8 | 1.6 |
| Consumer Price Index (all urban):[1] | | | | | | | |
| CBO January | 2.1 | 2.2 | 2.5 | 2.5 | 2.5 | 2.5 | 2.4 |
| Blue Chip Consensus January [2] | 2.2 | 2.2 | 2.5 | 2.6 | 2.5 | 2.5 | 2.4 |
| 2004 Budget | 2.2 | 2.1 | 2.1 | 2.2 | 2.2 | 2.3 | 2.2 |
| Unemployment rate:[3] | | | | | | | |
| CBO January | 5.9 | 5.8 | 5.4 | 5.3 | 5.3 | 5.2 | 5.5 |
| Blue Chip Consensus January [2] | 5.9 | 5.5 | 5.1 | 5.1 | 5.1 | 5.1 | 5.3 |
| 2004 Budget | 5.7 | 5.5 | 5.2 | 5.1 | 5.1 | 5.1 | 5.3 |
| Interest rates:[3] | | | | | | | |
| 91-day Treasury bills: | | | | | | | |
| CBO January | 1.4 | 3.5 | 4.8 | 4.9 | 4.9 | 4.9 | 4.1 |
| Blue Chip Consensus January [2] | 1.6 | 2.9 | 4.2 | 4.4 | 4.6 | 4.4 | 3.7 |
| 2004 Budget | 1.6 | 3.3 | 4.0 | 4.2 | 4.2 | 4.3 | 3.6 |
| 10-year Treasury notes: | | | | | | | |
| CBO January | 4.4 | 5.2 | 5.6 | 5.8 | 5.8 | 5.8 | 5.4 |
| Blue Chip Consensus January [2] | 4.4 | 5.2 | 5.6 | 5.8 | 5.7 | 5.7 | 5.4 |
| 2004 Budget | 4.2 | 5.0 | 5.3 | 5.4 | 5.5 | 5.6 | 5.2 |

Sources: Congressional Budget Office; Aspen Publishers, Inc., Blue Chip Economic Indicators.

[1] Year over year percent change.

[2] January 2003 Blue Chip Consensus forecast for 2003 and 2004; Blue Chip October 2002 long run for 2005–08.

[3] Annual averages, percent.

Chairman NUSSLE. Mr. Davis.

Mr. DAVIS. I don't want to weigh into this debate, but I want to take advantage of your expertise to clarify something for myself here. When we talk about or when I have read a lot about these notions of dynamic scoring, for some reason it seems that the debate seeks to estimate the economic impact of fiscal policy, of tax cuts, things of that nature. Can you shed some light for me, Mr. Secretary, about why these theories of dynamic scoring don't estimate the impact of, say, more spending on things such as education and health care, because it is my uninformed theory since I am not an economist, it is my theory that those things have some effect on the health of our economy as well, but it seems that people who engage the dynamic scoring issue don't focus on the potential economic impact from those things?

Secretary SNOW. I think, and I don't pretend to be an authority on this subject, I agree with the chairman that what we ought to do is do accurate scoring. But accurate scoring ought to take into account the way people respond, and people do respond to tax incentives.

Just a little story, I was in Beaufort, SC just last weekend and the historian was showing my wife and me and some friends around Beaufort. Beaufort is a unique city because it was occupied all during the war and the people left early in the Civil War and the antebellum homes are maintained. It was never destroyed. And on this tour, the historian pointed out the various houses and noted that a number of these houses didn't have any doors and that was curious. We asked him why. He said it was the first tax shelter. He said Beaufort in those days taxed houses by the number of doors, so people put in windows.

Mr. Chairman, just an illustration of the point, Tax Code is noted by people and they adjust their behaviors in accordance with it.

Mr. DAVIS. I do want to make one point before I yield the floor, Mr. Secretary. I have no doubt that that is true at some level, but the point I will leave you with is this. As we look at the priorities facing our country that it seems to me if we make the adequate investments in health care, if we make the adequate investments in education, that too will have an impact on people's behavior, because it will do one very fundamental thing. It will move people who have been at the margins of our economy into a more secure position, the middle class. It will ratchet up people's economic power, and I will leave you with the observation that that is something we should take into account.

Chairman NUSSLE. Mr. McCotter.

Mr. MCCOTTER. Quickly, I agree with that, but I think that the best way for people to come off the margins is to make more money and keep it and make the decisions on how to invest that money in their own lives through their family budgets. And the good news for the good Representative from Memphis, I was at the grocery store last night, and I am living a bachelor's life with my wife 500 miles away and I decided that ice cream was two for five bucks. I have a sweet tooth, what can I say? I go up to the counter and it dawns on me it is two for $5 if you have a bonus card for the grocery store. I immediately altered my behavior given the economic conditions to save myself about $2.50, and I am now a member of that grocery store's bonus club. So I think that economic decisions even down to the micro, micro——

Mr. FORD. You maybe ought to get Mr. Hubbard and Mr. Snow one of those bonus cards, too.

Mr. MCCOTTER [continuing]. And everyone's decisions are affected economically by the conditions in which they find themselves. The trouble we are having is not really an argument or a debate between you and Chairman Nussle. I think in many ways the reason we get economic forecasts that we find to be suspect or debatable is the same reason that every economic forecaster is not a very, very wealthy person. No one is right 100 percent of the time, and we have to make our best, most educated guess, whether it is dynamic, static or whatever, but primarily the needs of our constituents.

Chairman NUSSLE. Mr. Secretary, we always save the best discussion for last and I think that you have seen a little bit of our interests here today on the Budget Committee, and we very much appreciate you spending the time that you have with us when you certainly could be getting settled at your office. So we wish you Godspeed in your new position. I would commend to you that estimations—certainly I think you have heard here today—are an important priority and you work for the President, not necessarily the Congress, but if we could put it on your "to do" list, that would greatly assist us and, secondly, just to give you encouragement as a fellow tax reformer, be bold, don't shy away. Even though you may not see the light at the end of the tunnel just yet, there are many of us who are looking to you and others for leadership in this regard, so be bold with regard to tax reform. I think it is important at this juncture in our Nation's history.

I appreciate your time, and we look forward to the time we will spend together in the future.

Secretary SNOW. Thank you very much. I look forward to being invited back.

Chairman NUSSLE. With that, the hearing is adjourned.

[Whereupon, at 1:50 p.m., the committee was adjourned.]

○